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1992: The Case of Financial Services

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I. INTRODUCTION

By the end of 1992 the European Community (EC) intends to create a single internal market in goods, services, labor and capital.[1] Of all the internal markets to be created by the end of 1992, the single internal market in financial services[2] may be the most interesting.

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1 The creation of such a market was envisaged in 1957 by the Treaty of Rome, 1973 Gr. Brit. T.S. No.1 (Cmd 5179-II) (official English translation), 298 U.N.T.S. 11 (1958) (unofficial English translation). For contemporary comment see Efron & Nanes, *The Common Market and Euratom Treaties: Supranationality and the Integration of Europe*, 6 INT'L & COMP. L. Q. 670 (1957). Progress towards the aim of the single internal market was slow until, in 1985, the Commission of the European Communities (the Commission), the EC institution which is responsible for making proposals for legislation and for monitoring compliance with EC rules, produced the White Paper, *Completing the Internal Market* (Document COM(85) 310 final, June 1985), which led to the Single European Act of 1986, 30 O.J. EUR. COMM. (No. 169) 1 (1987), *reprinted in* 25 I.L.M. 506 (1986), and the 1992 deadline for the achievement of the internal market.

For the events leading up to the Single European Act see e.g. Lodge, *The Single European Act: Towards a New Euro-Dynamism?*, 24 J. COMM. MARKET STUDIES 203 (1986). On the Single European Act see Glaesner, *The Single European Act: Attempt at an Appraisal*, 10 FORDHAM INT'L L.J. 446 (1987).

2 When Price Waterhouse was commissioned to produce its report on the gains to be made from European integration it agreed with the Commission to define financial services as including the provision of a financial service, or the sale of a financial product, or both. The activities covered would be: international, commercial and private banking; corporate financial services; offshore bank-

This paper considers three aspects of the single market in financial services: regulatory harmonization as a solution to the problems caused by the development of international financial markets; the rules which the EC has adopted and proposed to create the single market in financial services; and the extent to which the single market will encourage competition between regulators.

The single internal market was designed to ensure the proper functioning of European financial markets in matching the supply of and demand for capital which is essential for the health of the European economy.[3] Nevertheless, in pursuing the single market goal, the EC has created a new method of dealing with the problems which worry all regulators of financial services activities. Unfortunately, the EC has not made the most of its opportunity. The rules are sometimes unclear, and it is not inevitable that they will achieve equivalent regulation throughout the EC. In addition, although each Member State has an interest in the achievement of the single market in financial services, each Member State also has a national interest in ensuring that it benefits from financial activity within the Community, even at the expense of its neighbors.

The achievement of the single market in financial services promises to promote the efficient allocation of capital in Europe and to produce significant immediate gains. The Community's total gain from completion of the internal market will probably exceed 200 billion ECU,[4] which represents between 4.3% and 6.4% of the Community's gross domestic product in 1988.[5] The creation of a single market in financial services may account for as much as one sixth of this total. As part of its vast

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ing and money market activities; brokering; funds management; assurance, insurance and reinsurance; consumer credit; building societies; and stock exchange services. *See* 9 Commission of the European Communities, Research on the 'Cost of Non-Europe', Basic Findings, *The Cost of Non-Europe in Financial Services* 3 (1988) [hereinafter Price Waterhouse Report]. This is part of the research which provided the foundation for the Cecchini report, *see* P. CECCHINI, THE EUROPEAN CHALLENGE: 1992 THE BENEFITS OF A SINGLE MARKET (1988).

[3] For recognition of this, see, e.g., the Commission Recommendation concerning a European code of conduct relating to transactions in transferable securities, 20 O.J. EUR. COMM. (No. 212) 37 (1977), Explanatory Memorandum at point 1; *see also* Emerson, Aujean, Catinat, Goybet & Jacquemin, *The Economics of 1992. The E.C. Commission's Assessment of the Economic Effects of Completing the Internal Market* 98 (1988): "The integration of financial markets across Community borders is uniquely important, however, in the sense that it will not only have important effects on the efficiency of the sector itself but also on the efficiency of resource allocation of sectors using financial markets."

[4] One ECU was worth US$1.22 on April 27, 1990.

The ECU is a currency made up from a basket containing specific amounts of ten European currencies. *See* Works, *The European Currency Unit: The Increasing Significance of the European Monetary System's Currency Cocktail*, 41 BUS. L. 483 (1986); Usher, *The Legal Regulation of the European Currency Unit*, 37 INT'L & COMP. L. Q. 249 (1988).

[5] P. CECCHINI, *supra* note 2, at 83.

project on the economic benefits of European integration, the Commission engaged Price Waterhouse to write a report on the 'Cost of Non-Europe in Financial Services'.[6] In this report, Price-Waterhouse estimated that integration of European capital markets would produce a gain of 11-33 billion ECU.[7] Integration should also produce other macroeconomic welfare gains because it will allow the pooling of risks and the equalization of interest rates.[8]

Currently, national regulation creates non-tariff barriers to trade and investment in the EC.[9] The Price Waterhouse report lists a number of these, but it emphasizes that there may be barriers which are not yet apparent because they are hidden in the fine detail of the rules, and that the impact of national regulations tends to depend on how they are applied.[10] The attainment of the single market in financial services involves the removal of existing barriers between Member States and the harmonization of new and existing rules. European integration should mean that national rules throughout the EC will tend to converge and prevent new barriers from arising. This process, however, involves costs: some financial firms exposed to new competition will fail.[11]

The internationalization of financial markets is the most important issue facing financial services regulators and firms today. Internationalization links the three aspects of the single market in financial services covered by this paper: (i) the need for harmonization of financial regulation, (ii) the EC's rules as an example of regulatory harmonization, and (iii) the possibility that regulatory authorities in different Member States will compete to develop the most popular regulatory system for financial services in the EC.

First, the removal of barriers between Member States, and the har-

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6 Price Waterhouse Report, *supra* note 2.

7 *Id.* at 166, 179. The report is explicit about the need for caution in interpreting quantification of the potential gains because the results are speculative, see Section 6.2, Potential Future Price Changes, *id.* at 144; in particular the figures 'represent a snap shot of the position before and after integration' and 'also assume a competitive market structure after integration', *id.* at 166. For the methodology adopted for the survey see Section 6 of the report, particularly Section 6.1, Introduction and Review of Methodology, *id.* at 139.

8 *Id.* at 25-27, 171-79.

9 *Id.* at 6. For a list of the barriers to integration, see *id.* at 62.

10 *Id.* at 63.

11 *See id.* at 179. "The gains from integration will result from the dynamic effect of economic integration and not simply as a result of removing the costs of meeting some of the existing regulations. In all countries consumers will benefit from European integration but some producers will come under pressure to survive in the single market. . . . In view of the potential benefits of European integration of financial and capital markets it is essential that steps are taken to rapidly complete the internal market in financial services." *Id.* On the risks firms will incur as a result of market integration see J. PELKMANS, MARKET INTEGRATION IN THE EUROPEAN COMMUNITY 56-57 (1984).

monization of regulation of financial services within the Community, involve the EC in dealing with the problems of international financial markets in a completely new way. The measures which the EC is adopting to achieve the single internal market in financial services, although designed primarily to achieve economic goals, may be far more effective than other, more traditional, attempts to deal with these problems by way of extraterritorial legislation or memoranda of understanding.

Second, it is interesting to consider the rules which the EC has adopted to eliminate the barriers between national financial services markets and to coordinate regulation throughout the Community. These rules are new, significant, and interesting in themselves, both in the context of international financial markets and as a focus for some questions about financial regulation which are significant beyond the EC's boundaries. For example, commentators in the United Kingdom have begun to debate whether functional regulation[12] is better suited to modern financial markets than institutional regulation,[13] which is the type of regulation envisaged by a central element of the legislative program designed to achieve the single market in financial services, the Second Banking Directive.[14] Other commentators have been considering what type of regulation is appropriate to particular types of financial activity.[15] The EC's financial services rules are not yet well-known in the United States, but will affect United States financial services firms which wish to carry on

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12 Functional regulation gears regulation to particular activities, regardless of the type of entity involved in the activities. The UK Financial Services Act, 1986, ch. 60, is an example of a functional scheme of regulation, and sets up a scheme for regulation of 'investment business'. However, the UK system does also involve institutional regulation: banks, building societies and insurance companies are all subject to regulation under separate statutory schemes. *See generally*, D. LOMAX, LONDON MARKETS AFTER THE FINANCIAL SERVICES ACT (1987).

13 Institutional regulation gears regulation to the type of entity carrying on an activity, whatever the activity. Under such a system, a bank involved in dealing in shares would be regulated by a banking regulator. *See* Dale, *Financial Regulation after the Crash*, 158 THE ROYAL BANK OF SCOTLAND REVIEW 3, 17 (1988) ("...the fragmentation of regulatory responsibilities both geographically between national authorities and functionally between bank, securities market and futures exchange regulators is becoming outdated in a global financial marketplace in which securities and banking markets are becoming increasingly integrated.")

14 Second Council Directive on the co-ordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions and amending Directive 77/780/EEC, 32 O.J. EUR. COMM. (No. L 386) 1 (1989) [hereinafter Second Banking Directive]. The Council is the EEC's legislative body.

15 *See, e.g.*, J. FRANKS & C. MAYER, RISK, REGULATION AND INVESTOR PROTECTION: THE CASE OF INVESTMENT MANAGEMENT (1989). Note that the EC's proposal for a Directive on capital adequacy of investment firms and credit institutions, COM (90) 141 final, O.J. EUR. COMM. (No. C 152) 6 (1990), will require the imposition of capital requirements on investment management firms. Franks and Mayer argue that a requirement of separation of client funds from the funds of the investment manager would be more appropriate.

business in Europe.[16]

Third, harmonization of the regulation of financial services in the EC is being achieved through the imposition of minimum rules which must apply throughout the Community. In promoting their own national interests, Member States may set off a race to the bottom with the consequence that only the minimum rules apply throughout the Community. Alternatively, one or more Member States may decide that they can attract financial services businesses to their territory by imposing more onerous rules. The situation may be compared to that of corporate law in the United States where there is a considerable body of literature dealing with the race between the States to the bottom, or top. Whether financial services regulation in the single market will involve a competition in laxity, or a competition to promulgate and enforce tough and effective rules, is not yet clear.

Although the EC rules on financial services are described as rules to create a single market, in reality they continue to divide the EC according to territorial boundaries. The EC allows these regulatory divisions despite the increasing internationalization of the markets themselves. As the markets become more global it becomes more important to question whether financial regulation should continue to be applied by reference to territorial limits. If there is to be a truly European market, the EC should go some way towards recognition of the internationalization of the markets by introducing regulation which operates at the EC level, rather than at the national level.

II. INTERNATIONALIZATION/GLOBALIZATION OF FINANCIAL MARKETS

Dramatic changes have occurred in world financial markets in recent years.[17] Increasingly, institutions dominate the markets. They hold a growing percentage of equities, and can therefore have an increasingly profound effect on the markets.[18] Throughout the world, governments

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16 *See infra* § III. E.

17 *See, e.g.*, PERSONAL FINANCIAL MARKETS ch. 10 (R. Carter, B. Chiplin & M. Lewis eds.1986). *See generally* M. WATSON, D. MATHIESON, R. KINCAID, D. FOLKERTS-LANDAU, C. REGLING & K. ATKINSON, INTERNATIONAL CAPITAL MARKETS. DEVELOPMENTS AND PROSPECTS Ch. III (1988); SEC Staff Report, Internationalization of the Securities Market, July 25, 1987; R. BRYANT INTERNATIONAL FINANCIAL INTERMEDIATION (1987); *Symposium: The Internationalization of the Securities Markets*, 4 B.U. INT'L L. J. 1 (1986); Poser, *Arbitrability of International Securities Disputes*, 12 BROOKLYN J. INT'L L. 675 (1986).

18 *See, e.g.*, SEC Staff Report, US SEC Division of Market Regulation, The October 1987 Market Break, Comm. Fut. L. Rep. (CCH), No. 322, Special Report, at ch.3 (Feb. 11, 1988) [hereinafter SEC Staff Report]. For a suggestion that the institutions adopt short-term investment policies which are harmful to the economy see L. LOWENSTEIN, WHAT'S WRONG WITH WALL STREET (1988).

have deregulated financial markets, removing exchange and interest rate controls. Regulatory authorities have removed controls on commissions.[19] Meanwhile, the financial markets have become more integrated: events in derivative markets, such as futures markets, now have such a significant impact on the underlying markets that the Securities Exchange Commission (SEC) has concluded that pricing in derivative markets leads price trends in the underlying equity markets.[20] As domestic markets have become more integrated, so have international markets. Events in one domestic market may affect another domestic market on the other side of the world.[21]

Firms involved in the investment business are constantly developing new markets and new products: recent examples are new financial futures markets,[22] swap transactions, securitization and options.[23] Financial conglomerates are now involved in activities which range from fund management to corporate finance, and from insurance to commercial banking. New technology has played an important role in these developments through encouraging the integration of markets and the development of new products and new markets.[24]

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19 On the removal of controls on commissions, see J. LORIE, P. DODD & M. KIMPTON, THE STOCK MARKET: THEORIES AND EVIDENCE (2d ed. 1985); Jarrell, *Change at the Exchange: The Causes and Effects of Deregulation*, 27 J.L. & ECON. 273 (1984); Miller, *Regulating Financial Services in the United Kingdom—An American Perspective*, 44 BUS. LAW. 323 (1989); Gower, *Big Bang and City Regulation*, 51 MOD. L. REV. 1 (1988); Terry, *The 'Big Bang' at the Stock Exchange*, 156 LLOYDS BANK REVIEW 16 (April 1985). *But see* Santos, *On Modes of Production of Law and Social Power*, 13 INT'L J. SOC. L. 299, 324 (1985) ("Deregulations are reregulations.").

20 SEC Staff Report, *supra* note 18, at ch. 3, pp 3-6. See Schick, *A Review and Analysis of the Changing Financial Environment and the Need for Regulatory Realignment*, 44 BUS. LAW. 43 (1988-89), for a suggestion that the stock market and the market for derivative instruments are no longer separate markets, but together form a single equity market and should therefore be regulated by a single regulatory agency.

21 *See* Report of the Presidential Task Force on Market Mechanisms, Comm. Fut. L. Rep. (CCH), No. 319, (Dec. 12, 1988)(Study I The Global Bull Market at I-1): "The birth of 24-hour markets made all markets functionally and psychologically interlocked."; SEC Staff Report, *supra* note 18, at ch. 2, ch. 11.

These effects were particularly noticeable during the world-wide market crash in October 1987. *See id.* at ch. 2, Para. 2-2. ("The October Market Break also highlighted the interconnections among securities markets internationally. Ripple effects of the market volatility were seen in strong, well-capitalized international markets such as London and Tokyo, as well as in fast growing, more speculative markets such as the Hong Kong Exchange, which closed for the week of October 19.").

22 *See, e.g.*, Hey, *Establishing the German Financial Futures Exchange*, 1989 INT'L FIN. L. REV. 22; J. WALMSLEY, THE NEW FINANCIAL INSTRUMENTS: AN INVESTOR'S GUIDE (1988); A. HERBST, COMMODITY FUTURES. MARKETS, METHODS OF ANALYSIS AND MANAGEMENT OF RISK (1986).

23 *See, e.g.*, R. BRYANT, *supra* note 17, at 51-57; M. WATSON, et al, *supra* note 17, at ch. III, App. II.; Falconer, *Securitisation in the United Kingdom*, BUTTERWORTHS J. INT'L BANKING & FIN. L. 105 (March 1989); 258 (June 1989).

24 GOURGUES & LAUTERBACH, REVOLUTION IN FINANCIAL SERVICES 6 (1987).

Each of these changes involves new challenges for regulation. The development of large financial conglomerates raises issues relating to conflicts of interest, competition and concentration, and supervision of multi-function firms by single-function regulators.[25] The development of new products and new markets means that effective regulation needs to be flexible.[26] The integration of markets means that it is increasingly difficult to apply regulation according to national boundaries. The combination of all of these changes makes the regulator's job particularly difficult: financial conglomerates operate throughout the world, as institutions with significant potential to affect the markets, investing in and developing new products.

The internationalization of the markets may be seen as the unifying thread in all these developments. For example, participants in the markets are not merely conglomerates, they are international conglomerates, formed of entities subject to different jurisdictions and subject to different legal regimes.[27] Of course, the internationalization of the markets has advantages, such as allowing investors to diversify across national boundaries more easily. In addition, issuers have access to new sources of capital, and markets become more liquid, and more efficient.[28] Although the markets have become more integrated, they are not yet completely integrated: differences between different markets remain.[29] In addition, the internationalization of the markets creates new problems for regulators: legislation tends to be restricted by reference to territory,[30] but regulators have to deal with problems which do not fall neatly within territorial

[25] Conglomerates now carry on banking, insurance, and investment business. *See, e.g.*, J. MAYCOCK, FINANCIAL CONGLOMERATES: THE NEW PHENOMENON 75-83 (1986). The Second Banking Directive, *supra* note 14, covers securities activities of banks, as well as banking activities, but does not extend to insurance activities.

[26] After the Market Crash in October 1987, attention focused on the use of derivative products and the use by institutions of passive investment strategies. *See, e.g.*, SEC Staff Report, *supra* note 18, at ch. 3.

[27] *See* COOPER & FRASER, *International Trends and Influences in Financial Regulation*, in BANKING DEREGULATION AND THE NEW COMPETITION IN FINANCIAL SERVICES ch. 3 (1984).

[28] SEC Staff Report, *supra* note 18, at 11-1. On international diversification see INTERNATIONAL FINANCIAL HANDBOOK § 8.2 (George & Giddy eds. 1983).

[29] SEC Staff Report, *supra* note 18, at 11-1 ("Although the markets are increasingly interdependent, they also have retained their individuality and have resisted complete integration. Globalized markets continue to have different structures and operating rules."). *Id.*

[30] *See, e.g.*, the United Kingdom, Financial Services Act, 1986, ch. 60, § 3, which requires authorization for the carrying on of investment business in the UK, and Section 1, which defines carrying on investment business in the UK. Other provisions of the statute with territorial limitations include Section 47(5), which deals with market manipulation, and Section 57, which deals with the issue of investment advertisements; see also Section 207(3) for the circumstances in which an advertisement is treated as being issued in the UK.

limits.[31] For example, is a person who produces a tip-sheet in the United Kingdom which is distributed only in France carrying on investment business in the United Kingdom? If the tip-sheet producer knowingly publishes false information about shares in a company listed on the Luxembourg Stock Exchange and encourages its subscribers to invest in those shares, is an offense of market manipulation committed in France, in Luxembourg, or in both countries? What law governs whether the investors have a civil remedy against the tip-sheet producer?

A. Solutions to Problems Caused by the Internationalization of the Markets

Although international cooperation in financial regulation involves collective action problems, States have adopted different solutions to these problems and have tended to act in their own national interests, ignoring the collective good.[32] So far, most attempts to solve the problems of international financial markets have focused on the effective enforcement of national laws. For example, States have entered into general multilateral treaties such as the Hague Convention on the Taking of Evidence Abroad in Civil or Commercial Matters, which may be used to obtain information in other jurisdictions.[33]

Courts have adopted another strategy, interpreting municipal legislation to apply to acts abroad which have effects within the courts' jurisdiction.[34] This approach has the disadvantage that it is likely that other

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[31] *See* SEC Staff Report, Internationalization of the Securities Market, (July 25, 1987); *BAT Industries plc*, Panel on Takeovers and Mergers, Reasons for the decision of the Appeal Committee (Sept. 29, 1989); Grass, *Internationalization of the Securities Trading Markets*, 9 HOUS. J. INT'L L. 17 (1986). For an example of a court facing problems in international financial markets see, e.g., Libyan Arab Foreign Bank v Bankers' Trust, [1989] QB 728.

[32] *See*, R. BRYANT, *supra* note 17, at ch. 8, suggesting the need to evolve international political institutions; and, on collective action generally, *see* F. HIRSCH, SOCIAL LIMITS TO GROWTH (1976); M. OLSON, THE LOGIC OF COLLECTIVE ACTION (1971).

[33] Opened for signature, 23 U.S.T. 2555 (Mar. 18, 1970). For an example of an application under this Treaty in England to obtain information on a revenue matter see Re State of Norway's Applications (Nos 1 and 2), [1989] 1 All E.R. 746. Also see the Santa Fe case for successful use of this convention in a securities matter: SEC v. Certain Unknown Purchasers of Common Stock, Civ. No. 81-6553 (S.D.N.Y. 1986), *aff'd.*, 817 F. 2d 1018 (2d Cir. 1987), *cert. denied*, 56 U.S.L.W. 3568 (U.S. Feb. 23, 1988). *See also* Casenote, *US Obligations under the Hague Evidence Convention: More than Mere Good Will?*, 22 INT'L LAW 511 (1988).

[34] *See, e.g.*, Leasco Data Processing v. Maxwell, 468 F.2d 1326 (2d Cir. 1972), where US law was applied to a non-resident alien who was held to have engaged in significant conduct in the US in breach of the United States securities laws in relation to transactions overseas.

See Goelzer, Mills, Gresham & Sullivan, *The Role of the US Securities and Exchange Commission in Transnational Acquisitions*, 22 INT'L LAW. 615, 619-20 (1988); MacIntosh, *The Impact of Extraterritoriality on World Banking*, in THE INSTITUTE OF BANKERS, COMPETITION AND CO-OPERATION IN WORLD BANKING (1985); Grossfeld & Rogers, *A Shared Values Approach to Jurisdic-*

countries affected by what they see as the extraterritorial operation of the legislation will be offended and refuse to assist or even block the activities of the regulators in question.[35] National rules providing for secrecy in certain circumstances, such as in relation to banking activities, may also impede the effectiveness of extraterritorial legislation.[36]

Bilateral agreements to cooperate in the enforcement of regulation, such as those which the United States and Japan,[37] and the United States and the UK have concluded,[38] are a more satisfactory solution to the problem of enforcing national rules in the context of international markets, and are an important development. At present, however, the bilateral agreements which exist are not sufficiently comprehensive to be really effective. These agreements are designed to help regulators to obtain information from their counterparts in other jurisdictions, but they are not helpful if the foreign regulators are inefficient, or if the foreign law does not regulate the activities in question.

A completely new solution to the problems caused by international markets would be the creation, through multi-lateral agreements between many states, of a transnational regulatory body, or several such bodies, and the acceptance of common principles for regulation.[39] The program which the EC is adopting to achieve the single internal market in finan-

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tional Conflicts in International Economic Law, 32 INT'L & COMP. L.Q. 931 (1983); Maier, *Extraterritorial Jurisdiction at a Crossroads: An Intersection between Public and Private International Law*, 76 AM. J. INT'L L. 280 (1982)

35 *See, e.g.*, the Protection of Trading Interests Act 1980, ch. 11, which was introduced to combat the extraterritorial effects of United States anti-trust rules, but which may be used against any country, and in a wide range of circumstances.

36 *See, e.g.*, Szat, *International Co-operation in Insider Trading Cases*, 40 WASH. & LEE L. REV. 1149 (1983).

37 *See* Japan-United States Memorandum of the United States Securities and Exchange Commission and the Securities Bureau of the Japanese Ministry of Finance on the Sharing of Information, May 23, 1986, *reprinted in* 25 ILM 1429 (1986).

38 *See* UK-United States Memorandum of Understanding on Exchange of Information in Matters Relating to Securities and Futures, Sept. 23, 1986, *reprinted in* 25 ILM 1431 (1986). *See also* Canada-US Memorandum of Understanding on Administration and Enforcement of Securities Laws, *reprinted in* 27 ILM 412 (1988); Goelzer, Mills, Gresham & Sullivan, *supra* note 34, at 636-41.

The International Securities Enforcement Cooperation Act of 1990 is designed to improve international co-operation in the enforcement of securities laws and to allow the SEC to restrict the activities in the US securities markets of those who have been engaged in misconduct in other countries. *See* International Securities Enforcement Cooperation Act of 1990, Securities Reforms of 1990, Fed. Sec. L. Rep. (CCH) No. 1424, Part II at 106 (Jun. 12, 1990). *Cf.* Part III of the UK Companies Act, 1989, ch. 40, dealing with powers to assist overseas regulatory authorities; *see also*, THE SECURITIES AND INVESTMENTS BOARD, THE FINANCIAL REGULATION OF OVERSEAS INSTITUTIONS WITH UK BRANCHES. A CONSULTATIVE DOCUMENT (March 1988).

39 *Cf.* the activities of the Cooke Committee in promoting cooperation between banking supervisory authorities, and those of IOSCO in promoting cooperation between securities regulators. *See, e.g.*, R. BRYANT, *supra* note 17, at 144-49.

cial services is a solution of this type, although the EC has not yet created a single Euro-regulator for financial services activity, but instead relies on regulation by national authorities. The EC scheme should enhance the effectiveness of national rules where extranational elements are present, and should also result in a common core of principles and rules applied in a territorial area occupied by many separate states.[40] The attempt to achieve this solution is ambitious and may in the end not be wholly successful, but it is a new departure.

The new departure has not, however, changed incentives. Each Member State retains its national interest in ensuring that it benefits from financial activity within the Community. National governments say that they regulate financial services to protect investors so as to ensure that funds are available for national industry.[41] When a state's financial markets are dominated by national savers and borrowers, the government of that state must act to protect those savers and borrowers in order to stay in power. However, when savers and borrowers in a nation's markets are largely foreign, and national savers and borrowers are involved in foreign markets, the connection between investor protection and votes is weakened. In these circumstances the state's and government's real interest in its financial markets is not in the encouragement of investment by protecting investors, but in the capture of employment and revenue produced by those markets, even if this capture is at the expense of other states.

In practical terms, internationalization results in national authorities losing a significant degree of control over the national economy[42] and the protection of national savers and borrowers. Internationalization also means that regulatory priorities may change: regulation is likely to be designed to attract business, rather than to provide the highest possible degree of protection for small investors. The probable result is a

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40 *See* Note, *Toward the Unification of European Capital Markets: The EEC's Proposed Directive on Insider Trading,* 11 FORDHAM INT'L L. J. 432 (1988), describing EC harmonization as a step to global cooperation. On the coordination, approximation, or harmonization process see: Vogelaar, *The Approximation of the laws of Member States under the Treaty of Rome,* 12 COMMON MKT. L. REV. 211, 213 (1975) (arguing that harmonization "has a law-making function quite independent of compromises as between national provisions"). *See also* Roth, *The European Economic Community's Law on Services: Harmonization,* 25 COMMON MKT. L. REV. 35 (1988).

41 *See, e.g., Financial Services in the United Kingdom. A New Framework for Investor Protection,* CMND 9432 at ch. 1 (1985); Note, *Stock-Exchange Regulation in Germany,* 1908 J. POL. ECON. 369.

42 *See* R. BRYANT, *supra* note 17, at 91-94. "The undermining of the autonomy of macroeconomic policies and the controllability of nations' economies that results from increasing economic interdependence are among the most important manifestations of the growing salience of collective-action problems with international dimensions". *Id.* at 94.

competition between different national regulators to develop regulation which is attractive to financial services firms.

III. EXISTING AND PROPOSED EC LEGISLATION — ACHIEVEMENT OF THE GAINS FROM INTEGRATION AND SOLUTION OF THE PROBLEMS OF INTERNATIONALIZATION

In order to consider whether the EC's approach to achieving the single market in financial services may be useful as a blueprint for wider regulatory harmonization, it is necessary to examine the key elements of this approach. The EC's approach to the single market has two basic aims: the elimination of barriers between national markets within the EC, and the coordination of regulation of those national markets across the EC. In 1977, the Commission described its aim as being to encourage the interpenetration of the financial markets of the Member States by reducing the disparities between the different markets and by improving the safeguards available to savers.[43] EC legislation has started to achieve this aim, and the Commission has put forward proposals for further legislation designed to allow financial services firms to carry on business throughout the Community, while protecting investors and creditors.

Much of this existing and proposed legislation requires all Member States to enact legislation providing for a specified minimum level of protection for depositors and investors. The Commission has chosen the Directive as the appropriate Community legislative instrument for this purpose. Directives require Member States to enact legislation which will achieve a particular result.[44] Member States, however, may choose

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[43] Although the existing differences between the various financial markets in the nine Member States have not so far constituted an insuperable barrier to a number of international transactions, the lack of full information on the securities themselves and ignorance or misunderstanding of the rules governing the various markets have certainly helped to confine the investments of the great majority of savers to the markets of the countries in which they live or to a few well-known major international securities.

A reduction in these disparities would therefore tend to encourage the interpenetration of the member countries' markets, particularly if this is accompanied by improving the safeguards available to savers.

Commission recommendation concerning a European code of conduct relating to transactions in transferable securities, 20 O.J. EUR. COMM. (No. L 212) 37, Explanatory Memorandum, point 2 (1977).

[44] Treaty of Rome, *supra* note 1, at Art. 189. Directives may be contrasted with Regulations which do not need to be implemented by national legislation in order to be binding, but are directly applicable by virtue of their nature. *See id.*

However, the doctrine of direct effect, see Van Duyn v. Home Office, Case 41/74, [1974] ECR 1337, may apply to Directives. Directives may create individual rights which municipal courts must recognize after the time limit for their implementation has passed, *see* Ratti, Case 148/78, [1979] ECR 1629.

In order to produce direct effects, a measure must be legally valid from the point of view of the form and method of implementation.[45] The Community has favored the use of Directives to achieve coordination of the laws of the Member States because Directives are flexible and Member States may implement them in a manner appropriate to local conditions.

Much of the substantive law of the EC already affects financial services firms, and will continue to do so after the single market in financial services has been achieved. Of the existing legislation affecting the single market in financial services, the EC's well-developed competition (antitrust) rules will be particularly important. Removing the barriers between Member States will encourage competition, but it will also encourage the development of large financial institutions operating throughout the EC which could ultimately reduce competition in financial services.[46]

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national courts, and the terms of the provision must be appropriate to confer rights on individuals. The provision must be clear and unambiguous, and unconditional, and its operation must not be dependent on further action being taken by Community or national authorities. *See* T. HARTLEY, THE FOUNDATIONS OF EUROPEAN COMMUNITY LAW 188 (2d ed. 1988); H. SCHERMERS & D. WAELBROECK, JUDICIAL PROTECTION IN THE EUROPEAN COMMUNITIES 124-37 (4th Ed.1987). *See also* Winter, *Direct Applicability and Direct Effect-Two Distinct and Different Concepts in Community Law*, 9 COMMON MKT. L. REV. 425 (1972); Timmermans, *Directives: Their Effect within the National Legal Systems*, 16 COMMON MKT. L. REV. 533 (1979).

45 In some circumstances the Member States' discretion about how to implement a Directive can be limited, depending on the objective to be achieved; for example, in Enka, Case 38/77, [1977] ECR 2203, the European Court held that the relevant provision should be introduced in the same way in each Member State *but cf.* Commission v. Italy, Case 363/85, [1987] ECR 1733. In Commission v. Italy, Case 300/81, [1983] ECR 449, the Court held that it was not appropriate to implement a Directive by means of administrative procedures, and that implementation must be clear and certain, and not subject to the risk of being changed at the whim of the authorities. In Commission v. Belgium, Case 301/81, [1983] ECR 467, the Court held that a Member State could not plead internal problems to excuse a failure to implement a Directive.

46 *See* Price-Waterhouse Report, *supra* note 2, at App. 5 ("There can be no certainty that an unified European financial market will not be a concentrated one, unless a pro-competitive regulatory regime is enforced"). *See also* the Council Regulation on the Control of Concentrations Between Undertakings, 32 O.J. Eur. Comm. (No. L 395) 1 (1989).

On the competition law of the EC, *see generally*, D. WYATT & A. DASHWOOD, THE SUBSTANTIVE LAW OF THE EEC, 341-474 (2d ed. 1987); B. BARACK, THE APPLICATION OF THE COMPETITION RULES (ANTITRUST LAW) OF THE EUROPEAN ECONOMIC COMMUNITY (1981); Joliet, *National Anti-Competitive Legislation and Community Law*, 12 FORDHAM INT'L L.J. 163 (1989); Mancini, *Access to Justice: Individual Undertakings and EEC Antitrust Law- Problems and Pitfalls*, 12 FORDHAM INT'L L.J. 189 (1989); Pescatore, *Public and Private Aspects of European Community Competition Law*, 10 FORDHAM INT'L L.J. 373 (1987); Marenco, *Competition Between National Economies and Competition Between Businesses—A Response to Judge Pescatore*, 10 FORDHAM INT'L L.J. 420 (1987); *European Community Competition Law—A Rejoinder by Judge Pescatore*, 10 FORDHAM INT'L L.J. 444 (1987); Canellos & Silber, *Concentration in the Common Market* (pts. 1 & 2), 7 COMMON MKT. L. REV. 5, 138 (1970); Dassesse, *EEC Competition Law Affecting Banking: Recent Developments and Future Prospects*, 3 J. INT'L BANKING L. 105 (1988); Hornsby, *Competition Policy in the 80s: More Policy Less Competition*, 12 EUR. L. REV. 79 (1987); Frazer, *Competition Policy after 1992: The Next Step*, 53 MOD. L. REV. 609 (1990).

Existing and proposed EC legislation divides financial services activities into three categories: banking and credit services; insurance services; and brokerage and securities services.[47] This functional categorization, however, may not reflect the reality of the marketplace as, for example, firms which offer banking services to the public may also offer securities services. The Second Banking Directive adopts an institutional[48] approach, envisaging that banks will be regulated under one scheme which will apply to a wide range of activities, including dealing in transferable securities, but excluding activities in relation to insurance policies. This approach may be contrasted with the one adopted in UK legislation affecting financial services activity, which contains significant elements of a functional[49] approach.

Participants in the financial markets no longer observe rigid distinctions between banking business and investment business, but may be involved in a wide range of financial services. For this reason, this paper will discuss the EC's rules and proposed rules on financial services as separate categories of rules regulating markets, investment products, and market participants. The topic of financial services regulation is too large to be covered as a whole, so some subdivision is necessary. Any categorization involves some problems, and there is some overlap between the categories used in this paper. For example, a rule prohibiting market manipulation may be seen as a rule about markets. If the manipulation consisted of false statements by a market participant about an investment product it would also be a rule constraining the techniques used by market participants to sell investments. This approach may be somewhat misleading, but the author considers it to be preferable to any other categorization.

A. Rules Regulating Markets

Measures designed to achieve the single market in financial services and those designed to achieve the liberalization of capital movement are closely linked.[50] Restrictions on the movement of capital within the EC

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47 *See* Price-Waterhouse Report, *supra* note 2, at Introduction 3, Main Report 3.

48 *See supra* note 13.

49 *See supra* note 12.

50 *See, e.g.*, Recital number 18 of the Second Banking Directive, *supra* note 14; F. BURROWS, FREE MOVEMENT IN EUROPEAN COMMUNITY LAW, Part III (1987); the Price Waterhouse Report, *supra* note 2, at App.; Forwood & Clough, *The Single European Act and Free Movement—Legal Implications of the Proposals for the Completion of the Internal Market*, 11 EUR. L. REV. 383, 391-92 (1986); Governor of the Bank of England, *The Single Market and its Implications for Europe's Monetary Arrangements*, BANK OF ENGLAND Q. BULL. 62 (Feb. 1990); Oliver & Bache, *Free Movement of Capital Between the Member States: Recent Developments*, 26 COMMON MKT. L. REV. 61 (1989);

constitute a real barrier to the development of an internal market in financial services, and the elimination of these restrictions is a central aim of the 1992 project.

Another essential element of the single market in financial services is the development of an EC-wide securities market. More than ten years ago, the EC began to harmonize procedures for listing securities on stock exchanges in the EC, and to require a minimum level of disclosure about listed securities throughout the Community. The Admissions Directive established minimum conditions to be satisfied before regulators in Member States could permit securities to be listed on their exchanges.[51] Similarly, the Listing Particulars Directive was designed to achieve "an adequate degree of equivalence in the safeguards required in each Member State" without making the safeguards completely uniform.[52] These Directives laid the foundations for an EC securities market, and the Commission has built upon these foundations with its measures to ensure mutual recognition of listing particulars, and of prospectuses for non-listed securities, so that a company whose securities are listed on one exchange in the EC, or marketed by means of a regulated prospectus in one Member State will be able to use one set of listing particulars, or one prospectus, to market those securities throughout the Community.[53]

Louis, *A Monetary Union for Tomorrow?*, 26 COMMON MKT. L. REV. 301 (1989); Thygesen, *The Delors Report and European Economic and Monetary Union*, 65 INT'L AFFAIRS 637 (1989).

51 *See* the Council Directive coordinating the conditions for the admission of securities to official stock exchange listing, 22 O.J. EUR. COMM. (No. L 66) 21 (1979) [hereinafter Admissions Directive]; the Council Directive coordinating the requirements for the drawing up, scrutiny and distribution of the listing particulars to be published for the admission of securities to official stock exchange listing, 23 O.J. EUR. COMM. (No. L 100) 1 (1980) *amended at* 30 O.J EUR. COMM. (No. L 185) 81 (1987) [hereinafter Listing Particulars Directive]; and the Council Directive on information to be published on a regular basis by companies the shares of which have been admitted to official stock exchange listing, 25 O.J. EUR. COMM. (No. L 48) 26 (1982).

In Re Stock Exchange Listing Directives, Case 390/85, [1988] 1 COMMON MKT. L.R. 146, the European Court held that Belgium's problems in implementing the listing directives did not excuse their non-implementation. Belgium had argued that its difficulties derived from the large number of points the legislation covered, the lack of precision of the Directives, which meant that the Member States had to develop precise rules, and the complexity of the national procedures involved.

52 Listing Particulars Directive, *supra* note 51, at Recital number 4; *see also* Admissions Directive, *supra* note 51, at Art. 5.

53 *See* Council Directive amending Directive 80/390/EEC coordinating the requirements for the drawing-up, scrutiny and distribution of the listing particulars to be published for the admission of securities to official stock exchange listing, 30 O.J. EUR. COMM. (No. L 185) 81 (1987); Council Directive amending Directive 80/390/EEC in respect of the mutual recognition of public-offer prospectuses as stock-exchange listing particulars, 33 O.J. EUR. COMM. (No. L 112) 24 (1990); Council Directive coordinating the requirements for the drawing up, scrutiny and distribution of the prospectus to be published when transferable securities are offered to the public, 32 O.J. EUR. COMM. (No. L 124) 8 (1989); Dept. of Trade and Industry, *Listing Particulars and Public Offer Prospectuses. Implementation of Part V of the Financial Services Act 1986 and Related EC Directives. Consultative Document.* (July 1990).

These Directives emphasize the importance of information in securities markets to protect investors, and to increase confidence in and ensure the proper functioning of the securities markets.[54] The introduction of mutual recognition of listing particulars and prospectuses is an important development which will make it easier and cheaper for companies to raise capital in more than one Member State. However, until accounting standards are harmonized throughout Europe, investors will need expert advice about the contents of listing particulars and prospectuses produced in other Member States.[55]

Similarly, the proposed Investment Services Directive will affect the way in which national stock exchanges operate in future. The proposal contains provisions designed to allow firms authorized to provide brokering, dealing or market-making services in their home Member State to join stock exchanges and financial futures and options exchanges in other Member States.[56]

The protection of investors and maintenance of investor confidence is a constant theme in the EC regulation of the securities markets.[57] In addition to provisions regulating disclosure to investors, the EC has also produced legislation to prohibit insider dealing,[58] and to require disclosure of dealings in the shares of listed companies.[59] In addition, the EC is attempting to prevent money laundering.[60]

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[54] *See, e.g.*, Council Directive coordinating the requirements for the drawing up, scrutiny and distribution of the prospectus to be published when transferable securities are offered to the public, 32 O.J. EUR. COMM. (No. L124) 8 (1989) (Recitals numbers 2 and 3). *Cf.* the Listing Particulars Directive, *supra* note 51, at Recitals numbers 5 and 6.

[55] On the harmonization of accounting standards see, e.g., INTERNATIONAL PRESSURES FOR ACCOUNTING CHANGE (A. Hopwood ed. 1989); Blanchet, *IASC E32 and the Future of International Harmonization of Accounting*, 6 J. INT'L BANKING L. 257 (1989); F. CHOI & R. LEVICH, THE CAPITAL MARKET EFFECTS OF INTERNATIONAL ACCOUNTING DIVERSITY (1990).

[56] *See* Explanatory Memorandum to the Proposal for a Council Directive on investment services in the securities field, COM(88) 778-SYN 176, 32 O.J. EUR. COMM. (No. C 43) 7, § I [hereinafter Explanatory Memorandum]. *See also* Amended proposal for a Council Directive on investment services in the securities field O.J. EUR. COMM. (No. C 42) 7 at Art. 13 (1990) [hereinafter Proposed Investment Services Directive]; Dept. of Trade and Industry, *EC Investment Services Directive. A Consultative Document* 23-4 (July 1990).

[57] *See, e.g.*, Admissions Directive, *supra* note 51, at Recital number 1; Listing Particulars Directive, *supra* note 51, at Recitals numbers 2 and 3.

[58] Council Directive coordinating regulations on insider trading, O.J. EUR. COMM. (No. L 334) 30 (1989); *See also* Dept. of Trade and Industry, *The Law on Insider Dealing. A Consultative Document* (undated); Hannigan, *Regulating Insider Dealing - The EEC Dimension*, [1989] 1 J. INT'L BANKING L. 11.

[59] Council Directive on information to be published when major holdings in the capital of a listed company are acquired or disposed of, 31 O.J. EUR. COMM. (No. L 348) 62 (1988); *see also* Dept. of Trade and Industry, *Disclosure of Interests in Shares: The EC Major Shareholdings Directive. A Consultative Document* (Feb. 1991).

[60] *See* Proposal for a Council Directive on prevention of use of the financial system for the

Eventually there should be a single securities market in Europe, supervised by a single regulatory authority. The EC's market orientated legislation is a first step towards such a market, and in September 1989, the Stock Exchanges in the EC Member States agreed to pursue a goal of creating a single stock market for Europe's largest companies.[61] This will take time; in addition to the practical problems of developing satisfactory clearing and settlement systems for such a market it will be necessary for progress to be made on the harmonization of accounting standards throughout Europe.

B. Rules Regulating Investment Products

Some of the EC's rules are designed to harmonize the rules governing securities markets in the Community directly, others are designed to harmonize the rules governing the securities traded on those markets. In particular, the harmonization of company law means that the incidents of share ownership in one Member State are more like those of share ownership in the other Member States than ever before. Article 54(3)(g) of the Treaty of Rome provides for the coordination of provisions of national company law to protect investors and creditors. The first of the company law Directives began to harmonize disclosure requirements, and introduced provisions to protect third parties dealing with a company against the risk that acts of the company and its organs might be invalid.[62] Other Directives harmonize rules dealing with the raising and maintenance of capital,[63] mergers,[64] the contents of annual

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purpose of money laundering, 33 O.J EUR. COMM. (No. C 106) 6 (1990), *amended* by 33 O.J. EUR. COMM. (No. C 319) 9 (1990).

61 *See* Waters, *EC Nations in Accord on Single Stock Exchange*, Fin. Times, Sept. 16, 1989, at 4, col. 4.

62 First Council Directive on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, with a view to making such safeguards equivalent throughout the Community, 11 O.J. EUR. COMM. (No. L 65) 8 (1968). On disclosure requirements, see also the Eleventh Council Directive concerning disclosure requirements in respect of branches opened in a Member State by certain types of company governed by the law of another State, 32 O.J. EUR. COMM. (No. L 395) 36 (1989).

63 Second Council Directive on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent, 28 O.J. EUR COMM. (No. L 26) 1 (1977); *see also* Proposal for a Council Directive amending Directive 77/91/EEC on the formation of public limited liability companies and the maintenance and alteration of their capital, 34 O.J. EUR. COMM. (No. C 8) 5 (1991).

64 Third Council Directive based on Article 54(3)(g) of the Treaty concerning mergers of public limited liability companies, 21 O.J. EUR. COMM. (No. L 295) 36 (1978).

accounts and consolidated accounts,[65] scissions,[66] and statutory auditors.[67]

There are many draft company law Directives, including the draft Fifth Directive[68] which is designed to regulate the relationships between the various organs of the company. The first draft of the proposal was produced in 1972. Progress since then has been impeded by the unwillingness of the United Kingdom to accept German-style provisions on worker participation.[69] Other proposals for legislation contain provisions about groups of companies,[70] cross border mergers,[71] single member private companies,[72] take-overs,[73] and the European Company.[74]

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65 Fourth Council Directive based on Article 54(3)(g) of the Treaty on the annual accounts of certain types of companies, 21 O.J. EUR. COMM. (No. L 222) 11 (1978); Seventh Council Directive based on Article 54(3)(g) of the Treaty on consolidated accounts, 26 O.J. EUR. COMM. (No. L 193) 1 (1983).

66 Sixth Council Directive based on Article 54(3)(g) of the Treaty, concerning the division of public limited liability companies, 25 O.J. EUR. COMM. (No. L 378) 47 (1982). This directive provides for demergers of public companies.

67 Eighth Council Directive based on Article 54(3)(g) of the Treaty on the approval of persons responsible for carrying out the statutory audits of accounting documents, 27 O.J. EUR. COMM. (No. L 126) 20 (1984).

68 *See*, Dept. of Trade and Industry, *Amended Proposal for a Fifth Directive on the Harmonization of Company Law in the European Community. A Consultative Document* (Jan. 1990); Welch, *The Fifth Draft Directive—A False Dawn?*, 8 EUR. L. REV. 83 (1983); Hamilton, *The Duties of Corporate Directors and the Draft Fifth Directive: Lessons from the United States*, 4 J. INT'L BANKING L. 152 (1988); Dine, *The Draft Fifth EEC Directive on Company Law*, 10 COMPANY LAW. 10 (1989).

69 *See* Opinion of the Economic and Social Committee on the Memorandum from the Commission entitled Internal Market and Industrial Cooperation- Statute for the European Company-Internal Market White Paper, point 137, 32 O.J. EUR. COMM. (No. C 23) 36 at para. 2.3 (1989).

70 Draft proposal for a ninth Directive on conduct of groups of companies, not yet formally adopted by the Commission.

71 Proposed 10th Directive on cross border mergers of public limited liability companies, 28 O.J. EUR. COMM. (No. C 23) 11 (1985).

72 The proposed 12th Directive on single member private companies, amended, COM(89) 193 final-SYN 135, 32 O.J. EUR. COMM. (No. C 152) 10 (1989).

73 The proposed 13th Directive on Company Law concerning takeover and other general bids COM(88) 823 final-SYN 186, 32 O.J. EUR. COMM. (No. C 64) 8 (1989). *See also* Dept. of Trade and Industry, *EC Proposal for a Thirteenth Company Law Directive Concerning Takeovers. A Consultative Document.* (Aug. 1989).

74 Proposal for a Council Regulation on the Statute for a European Company, COM(89) 268 final-SYN 218, 32 O.J. EUR. COMM. (No. C 263) 41 (1989). *See* Dept. of Trade and Industry, *Proposal for a European Company Statute. A Consultative Document.* (Dec. 1989); Opinion of the Economic and Social Committee on the Memorandum from the Commission entitled Internal Market and Industrial Cooperation—Statute for the European Company—Internal Market White Paper, point 137, 32 O.J. EUR. COMM. (No. C 23) 36 (1989).

On the harmonization of Company Law see generally, Dine, *The Community Company Law Harmonization Programme*, 14 EUR. L. REV. 322 (1989); Schmitthoff, *The Success of the Harmonization of European Company Law*, 1 EUR. L. REV. 100 (1976); THE HARMONIZATION OF EUROPEAN COMPANY LAW (C. Schmitthoff ed. 1973).

In addition to the provisions relating to company law, the EC has promulgated legislation relating to Undertakings for Collective Investment in Transferable Securities (UCITS), which are comparable to interests in mutual funds.[75] This EC legislation is designed to establish common basic rules for the authorization, supervision, structure and activities of UCITS, and for the information they must publish. The aim is to achieve free circulation of units in UCITS within the EC, and establish effective and more uniform investor protection as part of the project to create a European capital market.[76]

C. Rules Regulating Market Participants

Although the harmonization of rules governing financial markets and investments is important, much of the existing and proposed legislation designed to achieve the single market in financial services involves an elaboration of the general rules contained in the Treaty of Rome relating to freedom to carry on business in other Member States by setting up subsidiaries or providing services. These rules are known as the rules on freedom of establishment and freedom to provide services.[77]

A major element of the program to achieve freedom of establishment and freedom to provide services in the financial services context is the Second Banking Directive.[78] This Directive illustrates the 'new approach' which the Commission has adopted to speed up the process of coordination of national laws since the 1985 White Paper. The old approach involved the adoption of detailed harmonization measures. In contrast, the new approach concentrates on harmonization of essential standards for prudential supervision, so that the Member States can recognize each other's supervisory systems and accept each other's authori-

[75] The rules relating to UCITS are coordinated by the Council Directive on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), 28 O.J. EUR. COMM. (No. L 375) 3 (1985), as amended at 31 O.J. EUR. COMM. (No. L 100) 31 (1988) [hereinafter UCITS Directive]. *See* Wooldridge, *The EEC Directive on Collective Investment Undertakings*, [1987] J. BUS. L. 329.

[76] *See* the UCITS Directive, *supra* note 75, at Recitals 2-4.

[77] *See* generally, D. WYATT & A. DASHWOOD, *supra* note 46, at 161-223; F. BURROWS, FREE MOVEMENT IN EUROPEAN COMMUNITY LAW at Chs. 5, 6 (1987); Maestripieri, *Freedom of Establishment and Freedom to Supply Services*, 10 COMMON MKT. L. REV. 150 (1973); Steindorff, *Freedom of Services in the EEC*, 11 FORDHAM INT'L L.J. 347 (1988).

[78] *See supra* note 14. The Second Banking Directive amends the First Council Directive on the co-ordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions, 20 O.J. EUR. COMM. (No. L 322) 30 (1977) [hereinafter First Banking Directive]. For the background to the Second Banking Directive see Zavvos, *The Integration of Banking Markets in the EEC: The Second Banking Directive*, 2 J. OF INT'L BANKING L. 53 (1988). *See also* Zavvos, *Towards a European Banking Act* 25 COMMON MKT. L. REV. 263 (1988) [hereinafter Zavvos, *Banking Act*].

zations to carry on banking business. A bank authorized to carry on banking business in one Member State should be able to carry on banking business throughout the Community. Because of this, authorization to carry on banking business in the EC is known as the single banking license.[79] The most important aspects of the approach adopted by the Second Banking Directive and related legislation[80] are rules for a "single banking license" valid throughout the Community, comparable to the rules for mutual recognition of listing particulars and prospectuses, coordination of prudential rules, reciprocity and home country control. The State in which a bank or credit institution has its head office and is authorized is described as its "home" State, a State where it establishes a branch, or where it provides services to customers is described as the "host" State.[81] Similar approaches are being adopted in relation to insurance[82] and investment services.[83] Significantly, many of the provisions of

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79 *See* Second Banking Directive, *supra* note 14, at recital 4. *See also* the Commission's background report on Financial Services, Common Mkt. Rep. (CCH) ¶ 95,064. For comments on the "new approach" see *Making the Common Market Work,* 25 J. COMM. MARKET STUD. No. 3 (1987) (special issue edited by Robson & Pelkmans).

80 See for example the proposals and legislation on prudential matters: (1) Council Directive on the own funds of credit institutions, 32 O.J. EUR. COMM. (No. L 124) 16 (1989) (Directive defining what may constitute a credit institution's capital); (2) Council Directive on a solvency ratio for credit institutions, 32 O.J. EUR. COMM. (No. L 386) 14 (1989) (Directive providing that Member States are to ensure that ratios are to be established for credit institutions expressing their own funds as a proportion of their total risk-adjusted assets and off-balance sheet items. Provisionally, credit institutions are not to allow the ratios to fall below 8%, although the competent authorities of Member States may establish higher ratios as they consider appropriate). *See also* Spencer & Murray-Jones, *Capital Adequacy: Towards a Level Playing Field,* 1988 INT'L FIN. L. REV. 19, 20-21; Note, *The Proposed Risk-Based Capital Framework: A Model of International Banking Co-operation?,* 11 FORDHAM INT'L L.J. 777, 794-800 (1988); (3) The Commission Recommendation on monitoring and controlling large exposures of credit institutions, 30 O.J. EUR. COMM. (No. L 33) 10 (1987); (4) Commission Recommendation concerning the introduction of deposit guarantee schemes, 30 O.J. EUR. COMM. (No. L 33) 16 (1987).

These measures form an integral part of the scheme proposed under the Second Banking Directive. *See also* Proposal for a Council Directive on the co-ordination of laws, regulations and administrative provisions relating to the reorganization and winding up of credit institutions, COM(85) 778 final, O.J. Eur. Comm. (No. C 365) 55 (1985), *amended* by COM(88)4, O.J. Eur. Comm. (No. C 36) 1 (1988).

81 *See* Second Banking Directive, *supra* note 14, at Art. I, para. 7 & 8.

82 *See e.g.* Amended proposal for a second Council Directive on the co-ordination of laws, regulations and administrative provisions relating to direct life assurance, laying down provisions to facilitate the effective exercise of freedom to provide services and amending Directive, 33 O.J. EUR. COMM. (No. C 72) 5 (1990); Proposal for a third Council Directive on the coordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance and amending Directives 73/239/EEC and 88/357/EEC, 33 O.J. EUR. COMM. (No. C 244) 28 (1990); Dept. of Trade and Industry, *EC Third Non-Life Insurance (Framework) Directive. A Consultative Document.* (Feb. 1991).

In all of the Member States in the Community the insurance sector is regulated to protect consumers, to protect national capital markets, and to raise tax revenues. *See* J. PELKMANS, *supra* note 11, at 179; Pool, *Moves Towards a Common Market in Insurance,* 21 COMM. MARKET L. REV.

these Directives establish minimum standards for Member States to apply to firms authorized by their competent authorities. The Second Banking Directive establishes minimum requirements for: initial capital,[84] investigation of the suitability of those who have qualifying holdings,[85] the approval and supervision after authorization has been obtained of those who have qualifying holdings,[86] control of the ownership of qualifying holdings by banks,[87] and for professional secrecy obligations imposed on those involved with the competent authorities.[88] The imposition of such minimum requirements was necessary to persuade Member States to agree that a banking license granted by one Member State should be effective throughout the Community.

D. The Single Authorization Valid Throughout the EC

The EC's rules about securities markets benefit companies raising capital in more than one Member State. These rules, along with the rules on investment products, benefit investors who wish to diversify their holdings across territorial boundaries. In contrast, the single banking license benefits both banks and their clients, encouraging competition between banks in the Community.

The idea of the single banking license was introduced in the First Banking Directive.[89] In that Directive, the Council expressed its aim to achieve a situation where banks authorized in one Member State should be free to set up branches in other Member States,[90] and where domestic banks and those from another Member State should be able to compete

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123 (1984); Chappatte, *Freedom to Provide Insurance Services in the European Community*, 9 EUR. L. REV. 3 (1984).

83 Proposed Investment Services Directive, *supra* note 56. The investments covered by the proposed Directive are: a) transferable securities including units in undertakings for collective investment in transferable securities; b) money market instruments (including certificates of deposit and eurocommercial paper); c) financial futures and options; and d) exchange rate and interest rate instruments. *See id.* at Annex, § B.

Investment services include: a) brokerage; b) dealing as principal; c) market making; d) portfolio management; e) arranging or offering underwriting services in respect of issues of transferable securities and distribution of such issues to the public; f) professional investment advice to investors on an individual basis, or on the basis of private subscription; and g) safekeeping and administration.

84 Second Banking Directive, *supra* note 14, at Art. 3.

85 *Id.* at Art. 4.

86 *Id.* at Art. 9.

87 *Id.* at Art. 10.

88 Article 14 of the Second Banking Directive, *supra* note 14, substitutes a new Article 12 for the existing Article 12 in the First Banking Directive, *supra* note 78, and requires Member States to ensure that information obtained by competent authorities and persons involved with them, including those who carry out statutory audits, is subject to an obligation of professional secrecy.

89 *See supra* note 78.

90 First Banking Directive, *supra* note 78, at Recital 10.

on equal terms.[91] The Council promised that legislation designed to achieve these aims would provide for depositor protection together with the maintenance of competition.[92] However, the First Banking Directive did not achieve this aim: in 1977 the differences between the laws of the Member States relating to banking were thought to be so extensive that coordination would have to proceed in stages.[93] The First Banking Directive was the first stage in this process.[94]

The Second Banking Directive continues the process started by the First Banking Directive. The Directive permits banks authorized in one Member State to carry on business throughout the EC without the need to obtain authorization in the host state before commencing business.[95] The Directive contains minimum standards for the authorization of banks; for example, the general rule is that a competent authority must not grant authorization where the bank's initial capital is less than 5 million ECU.[96] In addition, competent authorities must appraise the suitability of shareholders or members who have "qualifying holdings" in banks when deciding whether or not to grant an authorization.[97] Regulation of the suitability of those involved in managing a bank is not referred to in the Directive, and may be a matter within the competence of the host state.[98]

The provisions of the proposed Investment Services Directive reflect the provisions of the Second Banking Directive. The proposed Investment Services Directive provides for mutual recognition of authorization, and sets out conditions for the grant of authorization. In order to become authorized, an investment firm must have sufficient financial re-

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91 *Id.* at Recital 4.

92 *Id.*

93 *Id.* at Recital 3.

94 For a description of the Directive as "tepid and compromising" see Fine, *The Second EEC Banking Directive: A Practical Overview*, 5 J. OF INT'L BANKING L. 197, 198 (1988). For a suggestion that the First Banking Directive was an important step to the creation of a European Banking law, introducing banking regulation where there was none (the United Kingdom), and introducing important changes elsewhere (the Netherlands, Luxembourg, Denmark) see Clarotti, *The Harmonization of Legislation Relating to Credit Institutions*, 19 COMM. MARKET. L. REV. 245, 266-67 (1982).

95 Second Banking Directive, *supra* note 14, at Art. 6(1). *Cf.* First Banking Directive, *supra* note 78, at Art. 4.1, which allowed a host Member State to require such an institution to apply for authorization in the host Member State. Banks established in other Member States were entitled to enter the host state's market on the same terms as domestic banks, but the requirement that a branch of a bank authorized in another Member State should possess adequate minimum endowment capital, referred to as "own funds", operated as a barrier to entry.

96 *See* Second Banking Directive, *supra* note 14, at Art. 4.1., Art. 4.2, for exceptions to this rule.

97 *Id.* at Art. 5. A qualifying holding is a direct or indirect holding in an undertaking which represents 10% or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of the undertaking in which a holding subsists.

98 *See infra* text accompanying notes 106-125.

sources, and the reputation and experience of the persons who effectively direct the business of the firm must be satisfactory. In addition, those who have qualifying holdings in the firm must be suitable.[99] Authorization to carry on insurance business in the EC is affected by provisions similar to those which affect banking and investment services.[100] Harmonization of the requirements for authorization throughout the EC is an essential element of the mutual recognition of authorization.

Mutual recognition of authorization to carry on banking, investment and insurance business is only part of the story. Another important issue is who is to be responsible for supervising firms carrying on business in more than one Member State. The EC has decided that continuing supervision, as well as authorization, should be a matter for the home Member State, but there are important exceptions to this rule.

1. *Home Country Control*

The Second Banking Directive provides that banks will be supervised by the competent authorities of the home Member State, and contains provisions designed to help these authorities carry out their functions in other Member States.[101] Supervision of prudential rules applicable to investment firms is also generally within the exclusive competence of the competent authorities of the home Member State. The home Member State's prudential rules must require sound administrative and accounting procedures and internal control mechanisms, the separation of clients' and firm's money and securities, membership of compensation schemes to protect investors, the provision of information to the competent authorities, the keeping of adequate records, and the organization of firms to avoid prejudicing clients' interests, through conflicts of interest between the firm and its clients or between one of its clients and another.[102]

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99 The proposed Investment Services Directive, *supra* note 57, Art. 3, 4. "Qualifying holding" has the same meaning as in the "Second Banking Directive", *supra* at note 14; *see* Art. 1, par. 7 of the proposed Investment Services Directive. Banks which are authorized according to the provisions of the Second Banking Directive will not require a second authorisation for activities within the scope of the proposed Investment Services Directive.

100 *See, e.g.*, the Second Council Directive on the coordination of laws, regulations and administrative provisions relating to direct insurance other than life insurance and laying down provisions to facilitate the effective exercise of freedom to provide services and amending Directive 73/239, Directive 88/357, 31, O.J. EUR. COMM. (No. L 172) (1988). The Directive facilitates the provision of services by an insurance firm in a Member State where it is not established, and clarifies the powers of the supervisory authorities. The Directive covers measures to ensure the firm's activities continue to conform to the applicable law, and contains provisions which determine the law applicable to insurance transactions.

101 *See* Second Banking Directive, *supra* note 14, at Art. 13, 15.

102 The proposed Investment Services Directive, *supra* note 56, at Art. 11(1).

2. *Host Country Control*

The host Member State retains a significant degree of control over financial services firms which carry on business in its territory. For example, until Community measures are introduced to harmonize regulation of liquidity, host Member States are to supervise the liquidity of banks in co-operation with the competent authorities of the home Member State.[103] Regulation of market risk is a matter for the State which is home to the financial market on which the relevant transactions take place, in collaboration with the home State's competent authorities.[104] Host Member States also remain responsible for measures implementing monetary policy, although such measures may not discriminate against banks authorized in another Member State.[105] Host country rules regulating compensation schemes will apply to branches of investment businesses authorized in other Member States pending further harmonization.[106]

Compliance with these provisions is to be enforced in the first instance through the home Member State's competent authorities, although the host Member State may take certain measures to prevent further irregularities, including preventing further transactions by that institution in its territory. The host Member State may take action if the home Member State does not act.[107] In emergencies, the host Member State may take any precautionary measures necessary to protect the interests of depositors, investors and others to whom services are provided.[108] A similar provision applies in relation to investment services.[109] The Commission has the power to monitor Member State actions and has the power to decide whether the Member State shall amend or abolish any precautionary measures.

3. *Legal Provisions Justified on the Grounds of the Public Good*

The major limitation of the principle of home country control is that

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103 Second Banking Directive, *supra* note 14, at Art. 14.2.

104 *Id.* at Art. 15(3). As to market risk associated with the activities of banks, see Macey & Miller, *Bank Failures, Risk Monitoring and the Market for Bank Control*, 88 COLUM. L. REV. 1153, 1171 (1988).

105 Second Banking Directive, *supra* note 14, at Art. 14.2. The right of the host Member State to implement its own monetary policy is limited by EC legislation relating to the European Monetary System.

106 Proposed Investment Services Directive, *supra* note 56, at Art. 11(1).

107 Second Banking Directive, *supra* note 14, at Art. 21.3, 21.4.

108 *See id. supra* note 14, at Art. 21.7. If such measures are taken, the Commission and other Member States must be informed as soon as possible, and the Commission may require the Member State in question to amend or abolish the measures.

109 Proposed Investment Services Directive, *supra* note 56, at Art. 16(7).

the host Member State may require a bank or investment firm authorized in another Member State to comply with "legal rules. . .adopted in the interest of the general good".[110] The ability of the host State to act both in areas where coordination has not yet been achieved and in relation to legal rules to protect the general good means that the principle of home country control may be subject to significant limitations. The meaning of the phrase "legal rules. . .adopted in the interest of the general good" will be tested by litigation before the European Court.

The Second Banking Directive contains three references to legal provisions for the public good. First, the Preamble suggests that a host Member State may regulate the activities of firms established in another Member State, which are not authorized as banks in that State, and may regulate activities not covered by the proposed Directive.[111] However, the host Member State's rules must comply with EC law, must seek to protect the public good, and must not apply where the home Member State has imposed equivalent rules.

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[110] Second Banking Directive, *supra* note 14, at Art. 21.5; *see also id.* at Recitals 15, 16. Contrast this with the formulation in the original proposal for this Directive: "legal provisions in force. . . which are justified on the grounds of the public good". Proposal for the Second Banking Directive, COM(87) 715 final, 88/C 84/01, 31 O.J. EUR. COMM. (No. C 84) 1 at Art. 19.3 (1988). *See also* the proposed Investment Services Directive, *supra* note 56, at Art. 16(5).

[111] Second Banking Directive, *supra* note 14, at Recital 15 ("the host Member State may, in connection with the exercise of the right of establishment and the freedom to provide services, require compliance with specific provisions of its own national laws or regulations on the part of institutions not authorized as credit institutions in their home Member States and with regard to activities not listed in the Annex, provided that, on the one hand, such provisions are compatible with Community law and are intended to protect the public good and that, on the other hand, such institutions or such activities are not subject to equivalent rules under the legislation or regulations of their home Member States.")

The Directive covers a range of activities from traditional banking functions such as lending money to dealing in securities. The activities covered by the Second Banking Directive are:

1. deposit-taking and other forms of borrowing;
2. lending;
3. financial leasing;
4. money transmission services;
5. issuing and administering means of payment (credit cards, travellers' checks and bankers' drafts);
6. guarantees and commitments;
7. trading for own account or for account of the customers in: a) money market instruments, b) foreign exchange, c) financial futures and options, d) exchange and interest rate instruments, e) securities;
8. participation in securities issues and the provision of services related to such issues;
9. money brokering;
10. portfolio management and advice;
11. safekeeping of securities;
12. credit reference services; and
13. safe custody services.

Second Banking Directive, *supra* note 14, at Annex.

Second, the preamble also states that Member States must allow activities covered by the Directive to be carried on as they would be in the home Member State, as long as this does not conflict with the host State's legal rules to protect the general good.[112]

Host country rules for the public good may apply to business being carried on in a manner accepted in the home Member State but not in the host Member State. This suggests that the host state may prohibit activities which it would, for example, regard as market manipulation.[113] Other activities which could be covered by the term could include the use by particular types of firms of derivative products, portfolio insurance, and program trading. Host country rules may also apply to banks which are not covered by the Directive.[114]

Third, Article 21.5 of the Directive provides that host Member States may take action to enforce the legal rules they have adopted in the interest of the general good.[115] Under this provision a Member State may apply its own rules, adopted in the interest of the general good, even if, in doing so, it prevents a bank authorized in another Member State from acting in a way that would be allowed in its home country. A host Member State may therefore apply its own conduct of business rules[116] to

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112 *Id.* at Recital 16 ("the Member States must ensure that there are no obstacles to carrying on activities receiving mutual recognition in the same manner as in the home Member State, as long as the latter do not conflict with legal provisions protecting the general good in the host Member State.") Recital number 18 of the original proposal for this Directive, see note 110 above, referred to activities "being undertaken using the financial techniques of the home Member State", and "legal provisions governing the public good".

113 United Kingdom Financial Services Act, *supra* note 30, at § 47, ch.60, provides for a criminal offence of market manipulation. This provision is currently being interpreted to cover a wide range of activities. On section 47, *see* Au, *Stock Market Manipulation After the Financial Services Act 1986*, 2 J. INT'L BANKING L. 53 (1989).

114 In such a case the general rules on freedom of establishment and freedom to provide services would apply. *See supra* note 77.

115 Art. 21(5) of the Second Banking Directive, *supra* note 14, provides that host Member States have:

> "the power. . .to take appropriate measures to prevent or to punish irregularities committed within their territories which are contrary to the legal rules they have adopted in the interest of the general good. This shall include the possibility of preventing offending institutions from initiating any further transactions within their territories."

This provision gives more freedom to host States than did the corresponding provision of the proposal for this Directive. Art. 19.3 of the proposal, *supra* note 110, provided:

> "If the competent authority of the host Member State ascertains that an institution having a branch or providing services in its territory is not complying with the legal provisions in force in that Member State which are justified on the grounds of the public good. . .that authority shall request the institution concerned to put an end to the irregular situation."

116 Conduct of business rules govern the way in which a firm may carry on business, and cover matters such as conflicts between the interests of the firm and its clients. Conduct of business rules may, for example, require disclosure of commissions, and separation of the firm's funds from those of its clients.

banks authorized in other Member States. Thus, Member State A, which applies stringent conduct of business rules to banks which enter into transactions in its territory, may deprive banks authorized in State B, a state with relatively relaxed rules, of the competitive advantage they would otherwise have over banks authorized in State A.

The ability of host States to apply their own conduct of business rules to banks authorized in other Member States limits the opportunity for a competition between different regulatory regimes within the Community.[117] It may, therefore, require future harmonization to clear the way for competition between regulatory regimes. Indeed, the Commission has already expressed its intention to achieve the harmonization of conduct of business rules.[118]

Until harmonization of conduct of business rules is achieved, the European Court will have to decide whether a particular Member State's rules have been adopted in the interest of the general good. The European Court's approach is to try to find an interpretation which fits in with the general scheme of an instrument; when legislation is considered, preparatory documents, such as explanatory memoranda prepared by the Commission, are available but rarely used. The Court adopts a teleological method of interpretation, also described as decision-making on the basis of judicial policy.[119]

The European Court's recent decisions concerning restrictions on the freedom to provide services in the context of insurance may foreshadow the way in which the Court will deal with rules restricting banking or investment business. The Court held that the freedom to provide services could only be restricted where the general good was not protected by the rules of the Member State in which the provider of the service was established. In such circumstances, the Member State into which the service was supplied could apply its own provisions if these were objectively "justified by the general good" and applied to all entities

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117 Note that Member States may not find it easy to apply conduct of business rules to institutions authorized in other jurisdictions, as such rules are often applied through the authorization process. In the UK, people become authorized to carry on investment business under the Financial Services Act 1986, ch. 60, by being authorized by the Securities and Investments Board (SIB) directly, or by joining a self-regulating organization (SRO). The authorized person must then comply with the conduct of business rules of the SIB or SRO.

118 *See* Explanatory Memorandum, *supra* note 56, at I.

119 *See* T. HARTLEY, *supra* note 44, at 76-77. *See also* H. SCHERMERS & D. WAELBROECK, *supra* note 44, at 11-17 (referring to three categories of interpretative technique applied by the European Court: literal interpretation; systematic interpretation, or interpretation by analogy; and teleological interpretation); Usher, *The Influence of National Concepts on Decisions of the European Court*, 1 EUR. L. REV. 359 (1976).

operating in that State.[120]

The Court stated that restrictions on the freedom to provide services may be justified in order to protect consumers, because the present state of Community Law does not ensure that such protection is necessarily guaranteed by the home State's rules. Requiring separate authorization in the host state could be justified, subject to certain conditions, but requiring insurance firms to be established in the host state was excessive because it would eliminate the firm's freedom to provide services.[121] A Member State could require firms to seek authorization to carry on insurance business and could apply its own legislation on technical reserves and conditions of insurance, provided that these requirements did not exceed what was necessary for the protection of policy holders and insured persons.[122] The Insurance cases have been described, on the one hand, as an important step to the unification of the internal market,[123] and, on the other hand, as not opening up the market fully, and creating problems of interpretation.[124] In addition, the Court has been criticized for encouraging the idea that Member States could adopt intricate and incompatible systems of local control without interfering with competition in the EC.[125]

The Second Banking Directive and the proposed Investment Services Directive appear to allow even more freedom to Member States to interfere with competition in the EC, because they do not require the relevant rules to be "justified by the general good", but merely to have been "adopted in the interest of the general good". The Directives adopt the rhetoric of home state control, but the reality will be a substantial level of host state control.

4. *Prudential Rules and Rules for the Conduct of Business*

In addition to the provisions harmonizing authorization requirements, the Second Banking Directive also contains provisions to harmonize the continuing supervision of banks. National measures implementing the Directive must require that banks maintain their capi-

120 Re Insurance Services (Commission v. Germany), Case 205/84, [1986] ECR 3755, [1987] 2 Common Mkt. L.R. 69, 101, point 27.

121 Commission v. France, Case 220/83, [1986] ECR 3663; Commission v. Denmark, Case 252/83, [1986] ECR 3713; Commission v. Ireland, Case 206/84, [1986] ECR 3817.

122 Commission v. Germany, *supra* note 120.

123 Note, *Commission v Germany*, 22 INT'L L. 543, 554 (1988).

124 Note, *Insurance Cases*, 24 COMM. MARKET L. REV. 273 (1987).

125 Edward, *Establishment and Services: An Analysis of the Insurance Cases*, 12 EUR. L. REV. 231, 253 (1987).

tal at or above the level required at the time of authorization,[126] and require sound administrative and accounting procedures as well as adequate internal control mechanisms.[127] The Directive also requires national implementing measures for the continuing appraisal of the suitability of those who hold qualifying holdings in banks,[128] and for the national competent authorities to act where influence of those with qualifying holdings "is likely to operate to the detriment of prudent and sound management of the institution".[129]

The proposed Investment Services Directive contains similar provisions relating to the continuing supervision of investment firms covering: the suitability of those with qualifying holdings,[130] continuing compliance with the conditions for authorization,[131] and prudential rules.[132] The original proposal for an Investment Services Directive stated, in Article 9(2): "If the rules. . .are not appropriate to the nature of the investment service in question, Member States may adapt them or provide that they shall not apply."[133] The current version of the proposal would allow Member States to provide that the rules relating to separation of clients' and firm's funds and securities, and to compensation schemes, do not apply where the service is provided to business or professional investors, or where the firm handles no money or securities on behalf of clients. The current version of the proposal therefore allows Member States much less flexibility in deciding when a particular type of rule is appropriate than did the original proposal.

The proposed Investment Services Directive does not attempt to coordinate the conduct of business rules regulating the relationship between investment firms and their clients, because "there are considerable

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126 Second Banking Directive, *supra* note 14, at Art. 10.1.

127 *Id.* at Art. 13.2.

128 *Id.* at Art. 11.

129 Second Banking Directive, *supra* note 14, at Art. 11.5. Under the Directive Member States must also provide that banks may not have a qualifying holding representing more than 15% of its own funds in an undertaking other than a credit institution, financial institution, or an undertaking pursuing activities which are a direct extension of banking, or concern services ancillary to banking such as leasing, factoring, the management of unit trusts, the management of data processing services or any other similar activity. Total holdings in such non-banking undertakings must not exceed 60% of a credit institution's own funds. *See id.* at Art. 12. The restrictions are not absolute: for example, certain temporary holdings are excluded by Article 12.4, and it is possible to exceed the restrictions in exceptional circumstances under Article 12.5. The restrictions are designed to limit risk, and mirror many restrictions which may be found in the laws of the Member States.

130 Proposed Investment Services Directive, *supra* note 56, at Art. 10. *Cf.* Second Banking Directive, *supra* note 14, at Art. 11.

131 Proposed Investment Services Directive, *supra* note 56, at Art. 9.

132 *Id.* at Art. 11, *see supra* text at note 102.

133 For an argument that different rules are appropriate to different types of investment business, see J. FRANKS & C. MAYER, *supra* note 15.

divergences between Member States in the content of such rules and in the way in which they are applied."[134] The Commission intends that coordination of conduct of business rules will take place in the future. Until that happens the conduct of business rules which currently apply in the host Member State as a matter of national law or industry practice will apply, and investment firms which carry on business in more than one Member State will probably need to comply with a different set of rules in each State. Such firms will, therefore, need to invest resources in different compliance systems. This is one area where significant savings could be made.

E. Reciprocity

The reciprocity provisions of the Second Banking Directive and the proposed Investment Services Directive mean that undertakings from countries outside the EC which restrict the access of foreigners to their financial markets may be excluded from the EC's market.

The original proposal for the Second Banking Directive provided that applications for authorization by non-EC firms' subsidiaries should be notified to the Commission. The Commission could then investigate whether EC firms would be subject to restrictions on carrying on business in a foreign country; this review would ensure reciprocal treatment.[135] These provisions have since been relaxed; the preamble to the Directive states that the EC intends to keep its financial markets open to the rest of the world, and that it wishes to improve the liberalization of the global financial markets outside the EC.[136]

Member States are obliged to inform the Commission when they authorize a direct or indirect subsidiary of a company governed by the laws of a non-EC country to carry on business as a credit institution. Member States must also inform the Commission when an undertaking governed by the laws of a third country acquires a holding in a Community bank which would make the bank its subsidiary.[137] The Directive also provides that Member States must notify the Commission of difficulties which their banks encounter in establishing themselves or in carrying

134 Explanatory Memorandum, *supra* note 56, at § I.

135 *See* Proposal for the Second Banking Directive, *supra* note 110, at Art. 7. Similar reciprocity provisions apply to applications for authorization under the proposed Investment Services Directive. The Proposed Investment Services Directive, *supra* note 57, at Art. 7. In addition, the proposed Directive contains grandfathering provisions comparable to those of the Second Banking Directive; *see id.* at Art. 24.

136 *See* Second Banking Directive, *supra* note 14, at Recital 20. *See generally* Hankey, *Pride, Prejudice and Reciprocity in the Single Market*, 4 J. INT'L BANKING L. 161 (1989).

137 Second Banking Directive, *supra* note 14, at Art. 8.

on banking business in a non-EC country.[138] The Commission is to draw up periodic reports on the treatment of EC banks in non-EC countries. If a non-EC country appears to have failed to grant to EC banks "effective market access comparable to that granted by the Community" to banks from that non-EC country, the Commission may submit proposals for a mandate for negotiations to obtain comparable competitive opportunities for EC banks to the Council.[139] The Commission may itself initiate negotiations with a view to remedying the situation where it appears that EC banks in a non-EC country "do not receive national treatment offering the same competitive opportunities as are available to domestic banks and the conditions of effective market access are not fulfilled."[140]

Where such negotiations take place, the Commission may decide that Member States should retaliate against undertakings governed by the law of the non-EC country in question by limiting or suspending decisions on their applications for authorization and permission to acquire holdings in EC banks. States may not , however, apply these limitations or suspensions to banks which are already authorized in the EC.

Article 23 of the Directive protects rights acquired by non-EC banks which are not established in a Member State but supply services into a Member State. In addition, the Directive protects rights acquired by branches of foreign firms which commenced their activities according to the host Member State's rules before implementation of the Directive. Thus, a bank established in a non-EC country may avoid the reciprocity provisions of the Directive by establishing a subsidiary in an EC Member State and applying for authorization as a bank, or by acquiring a bank authorized in a Member State of the EC (subject to domestic rules restricting such acquisitions) before the entry into force of provisions implementing the Directive in the Member State in question.[141]

The Second Banking Directive provides a regime which is much more favorable to banks authorized within the EC than to those from outside the EC, and the provisions of the Directive relating to reciprocity have been described as trade protectionist measures.[142] Reciprocity pro-

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138 *Id.* at Art. 9.1.

139 *Id.* at Art. 9.3.

140 *Id.* at Art. 9.4.2.

141 Fine, *supra* note 94, at 199. *See* Gruson & Nikowitz, *The Second Banking Directive of the European Economic Community and its Importance for Non-EEC Banks*, 12 FORDHAM INT'L L.J. 205, 241 (1989); *see generally id.* at 229-40 (on the meaning of reciprocity).

See also id. at 241: "Due to comprehensive pressure, major differences in the Member States are likely to erode in the course of time. But a prudent choice of the Member State that offers the best opportunities for a particular business strategy might permit an institution to secure a head start over competitors."

142 Fine, *supra* note 94, at 199. *Cf.* G. YANNOPOULOS, CUSTOMS UNIONS AND TRADE CON-

visions do currently exist in the domestic laws of the Member States, and these provisions may provide for the removal of authorizations which have been granted.[143] In contrast, the EC provisions in the Second Banking Directive and proposed Investment Services Directive seem to apply only in relation to the initial authorization decision, but institutions established in a non-EC country would remain subject to provisions in the national laws of the Member States. The proposed Directive will involve a substantial change in that the cost of exclusion will become much higher: a non-Member State excluded from the Community's internal market will be excluded from an extremely large market.

F. Enforcement of the Obligations of Member States under EC Law

There are two methods of ensuring that Member States comply with Community Law. First, enforcement proceedings may be initiated by the Commission or by a Member State, and second, individuals may enforce rights conferred on them by the doctrine of direct effect in national courts.

The Commission has the power to act where a Member State has failed to fulfill an obligation under the Treaty of Rome, which includes a violation of Community legislation.[144] A Member State may also bring an enforcement action against another Member State. Individuals only have the right to enforce compliance by a Member State with EC legislation where that legislation is directly effective.[145] Where the Commission or a Member State has instituted enforcement proceedings, the European Court may rule that the defendant Member State has failed to fulfill its obligations under the Treaty, and the judgment is binding on the Member State.[146] The effectiveness of the Commission's enforcement proceedings in ensuring compliance with Community legislation is unclear. The Commission has expressed concern about the failure of Member States to

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FLICTS: THE ENLARGEMENT OF THE EUROPEAN COMMUNITY, ch. 7 (1988); R. HINE, THE POLITICAL ECONOMY OF EUROPEAN TRADE: AN INTRODUCTION TO THE TRADE POLICIES OF THE EEC, ch. 15 (1985).

143 *See, e.g.*, United Kingdom Financial Services Act, ch. 60, Part IX (1986). The reciprocity provisions of the United Kingdom legislation differ from those established by the EC. The Secretary of State may issue a notice where institutions connected with the United Kingdom may only carry on investment, insurance, or banking business in a foreign country on terms less favorable than institutions connected with that country. *Id.* at § 183. Notices issued may disqualify institutions connected with the foreign country from carrying on business in the United Kingdom, or may restrict or partially restrict their activities in the United Kingdom. *Id.* at § 184.

144 Treaty of Rome, *supra* note 1, at Art. 169-171; *see* T. HARTLEY, *supra* note 44, ch. 10; Dashwood & White, *Enforcement Actions under Articles 169 and 170 EEC*, 14 EUR. L. REV. 388 (1989).

145 Treaty of Rome, *supra* note 1, at Art. 170.

146 *Id.* at Art. 171.

comply with judgments of the European Court which "undermines the fundamental principle of a Community based on law".[147] It has been suggested that, "[s]ince the Community mechanism functions only if there is mutual trust and good will between the Member States and Community Institutions, excessive resort to enforcement actions might do more harm than good."[148]

Certain Community legislative measures confer rights on individuals which they may enforce in national courts. It seems unlikely, however, that Directives which impose positive obligations on Member States could confer such rights on individuals.[149] In addition, it appears that Directives are not capable of imposing obligations on individuals.[150] It follows that persons wishing to bring an action to enforce compliance with obligations must bring that action against an organ of a Member State.[151] When that happens, national courts must interpret national legislation designed to implement a Directive in order to give effect to the Directive, if possible.[152] However, if Community law is applied by national courts there is a risk of divergent interpretations.[153] Where litigation before national courts raises questions of Community law, including questions as to the validity and interpretation of acts of Community institutions, these questions may be referred by the national court to the European Court.[154] Where such a question arises before a court against the

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147 *See Sixth Annual Report to the European Parliament on Commission monitoring of the application of Community Law*, 81 O.J. EUR. COMM. (No. C 330) 1, 6 (1989).

148 T. HARTLEY, *supra* note 44, at 293.

149 *See* H. SCHERMERS & D. WAELBROECK, *supra* note 44, at 135: "Positive obligations usually leave a margin of discretion to the Member State as to the manner in which the acts are to be made and are therefore often not unconditional, clear and precise."

150 *See* Marshall v. Southampton and SouthWest Hampshire Area Health Authority (Teaching), Case 152/84, [1986] ECR 723. *Cf.* Foster v. British Gas PLC, Case C 188/89, [1991] 2 WLR 258, (distinguishing the position of a body which had been made responsible for providing a public service under the control of the state, whatever its legal form).

151 *See* T. HARTLEY, *supra* note 44, at 208-10 (suggesting there may be a problem in ascertaining which bodies are organs of the State). *Cf.* R v. Panel on Take-overs and Mergers *ex parte* Datafin plc, [1987] 2 WLR 699; R v. Panel on Take-overs and Mergers *ex parte* Guinness, [1989] 1 All E. R. 509.

152 *See* Von Colson and Kamann v. Land Nordrhein-Westfalen, Case 14/83, [1984] ECR 1891; Litster v. Forth Dry Dock & Engineering Co. Ltd, [1989] 2 WLR 634; *see also* Duke v. GEC Reliance, [1988] 1 All E. R. 626, 635 ("Where an Act is passed for the purpose of giving effect to an obligation imposed by a directive or other instrument a British court will seldom encounter difficulty in concluding that the language of the Act is effective for the intended purpose"); but see *id.* at 637 ("The EEC Treaty does not interfere and the European Court in the Von Colson case did not assert power to interfere with the method or result of the interpretation of national legislation by national courts.").

153 H. SCHERMERS & D. WAELBROECK, *supra* note 44, at 352.

154 *See* Treaty of Rome, *supra* note 1, at Art. 177. *See also* Barav, *Some Aspects of the Preliminary Rulings Procedure in EEC Law*, 2 EUR. L. REV. 3 (1977); Mashaw, *Ensuring the Observance of Law*

decisions of which there is no appeal the question must be referred by that court to the European Court.

The availability of interpretative rulings from the European Court limits the opportunity for divergent interpretations of Community law which would arise for example, from the interpretation of "adopted in the interest of the general good." The usefulness of the procedure, however, is limited. The procedure only applies where the decision on the question of Community law is a necessary element of the national court's decision. In addition national courts may prevent a question from reaching the European Court if they apply the *acte clair* doctrine, and state that the meaning of an EC legislative provision is clear, and therefore does not require interpretation.[155] A national court could therefore hold that it is unnecessary for the European Court to define the phrase "legal rules. . .adopted in the interest of the general good" because the meaning of the phrase is clear. If different national courts were to decline to refer this question to the European Court on the basis of different, 'clear', meanings of the phrase, significant differences could develop between the regulatory environments in the different states.

III. Race to the Bottom or Struggle to the Top?

A. The Start of the Race

The EC legislation and proposals for legislation which are designed to achieve the single market in financial services provide for minimum standards which must be adopted by the Member States. These minimum standards may not yet be adequate. The politics of the legislative process in the EC often result in harmonization Directives which are "watered down to make them politically acceptable".[156]

An examination of the Second Banking Directive and the proposed Investment Services Directive, and the process of negotiation they have involved, illustrate the difficulties the Community faces in developing legislation acceptable to all Member States. Although both the Second Banking Directive and the proposed Investment Services Directive will lay down minimum capital requirements, capital requirements alone will

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in the Interpretation and Application of the EEC Treaty: The Role and Functioning of the Renvoi d'interpretation under Article 177, 7 COMMON MKT. L. REV. 258 (1970), 7 COMMON MKT. L. REV. 423 (1970).

155 *See* T. HARTLEY, *supra* note 44, at 268-72.

156 J. PELKMANS, *supra* note 11, at 183. *But see* Zavvos, *Banking Act, supra* note 78, at 269 (suggesting that minimum standards are adequate, because minimum harmonization means "*sufficient* minimum elements. . .to ensure the protection of the depositor and investor as well as the safeguarding of the financial system taken as a whole").

not achieve all of the desired goals of regulation. Both the Directive and the proposal fail to harmonize conduct of business rules because Member States could not agree on what such rules should cover. Conduct of business rules are necessary because, for example, minimum capital requirements do not prevent a financial intermediary which manages funds from depleting a client's funds by churning.

The flexibility of the Directive as a legislative instrument may be advantageous as it avoids the application of legislative provisions in inappropriate cases, but the interests of investors and depositors may suffer where the minimum standards laid down in the Directive are weak and where national authorities are unwilling to take stronger action. Because the Directives impose minimum standards, the requirements actually imposed by the Member States may vary enormously in scope and stringency.[157] The use of Directives to achieve harmonization causes many small differences between national laws relating to regulation of the four economic freedoms: free movement of goods, services, labor and capital.[158] In theory, interpretative rulings by the European Court under Article 177 of the Treaty of Rome[159] should mean that EC rules are applied in the same way in all of the Member States.[160] Nonetheless, even if this result is achieved, equal application of inadequate rules is unsatisfactory.

Divergence between national laws within the EC may be caused by the sensitivity of businesses and governments to the risk of driving business offshore.[161] A Member State may decide to encourage financial institutions to subject themselves to its jurisdiction by imposing only the minimum requirements laid down in the relevant Directives.[162] Such financial institutions would benefit from a real competitive advantage[163]

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157 *See* Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 701-03 (1974) (suggesting that the imposition of federal minimum standards of conduct for management and corporations could resolve the problems caused for investors by the competition in laxity between the states in the United States in the context of corporate law). Cary points out that a federal minimum standard, once interpreted by the federal courts, could then be applied by state courts, and uniform rules would apply throughout the USA.

158 J. PELKMANS, *supra* note 11, at 157.

159 *See supra* note 1.

160 *See, e.g.*, Litster v. Forth Dry Dock & Engineering Co. Ltd., [1989] 2 WLR 634.

161 *See, e.g.*, *The Single European Market: Survey of the UK Financial Services Industry*, BANK OF ENGLAND Q. BULL. 407, 409 (Aug. 1989) "It was felt. . .that the United Kingdom needed to make efforts to retain its competitiveness, and that the authorities needed to ensure that the regulatory environment did not reduce the attractions of the UK market." *Id.*

162 *See* Meessen, *Europe En Route to 1992: The Completion of the Internal Market and its Impact on Non-Europeans*, 23 INT'L LAW. 359, 366 (1989) (suggesting that there may be a "competition of standards" in the EC).

163 The competitive advantage would derive from reduced costs of compliance. *See* Winter, *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEG. STUD. 251, 258-62 (1977)

over financial institutions subject to more severe rules laid down in another jurisdiction. All financial institutions would have a strong incentive to be regulated under the most relaxed system. This in turn would provide an incentive for all other Member States to relax their own rules in the hope of attracting financial institutions to their jurisdiction, or preventing flight from it. This is the famous "race to the bottom".[164] Already, there are signs that this race is beginning: the International Stock Exchange in London relaxed its rules for euro-currency securities in April 1989,[165] and announced further relaxations to its rules, including a reduction in the length of the trading record required of companies admitted to the Official List and the Unlisted Securities Market, in February 1990.[166]

The only inevitable benefits which would accrue to a Member State seeking to market a relaxed regulatory regime would be fees charged for authorization, and subsequent periodic fees. The real revenues to be gained from financial services firms would derive from sources such as taxes, and employment, rather than from fees imposed by the regulatory authorities. In any event, Member States will remain obliged to impose some regulation in order to comply with their EC obligations, which will reduce their opportunity to profit from regulation. The real benefits will arise in the Member State where firms carry on business. In theory, financial services firms are supposed to be subject to the rules that their home state imposes on them, but they will also be affected by rules in the states where they carry on business.[167] It is the failure to harmonize conduct of business rules which may lead to a meaningful competition in laxity.

(regarding costs imposed by regulation); Stigler, *Public Regulation of the Securities Markets*, 37 J. BUS. 117 (1964).

164 Some argue that there is a race to the bottom. *See, e.g.*, Cary, *supra* note 157, at 668 ("state action cannot be effective in providing a responsible corporate statute"); Weiss & White, *Of Econometrics and Indeterminacy: A Study of Investors' Reactions to "Changes" in Corporate Law*, 75 CALIF. L. REV. 551, 554-59, 603 (1987) ("there is little evidence that there exists an investor-dominated market for corporate law"); Fox, *The Role of the Market Model in Corporate Law Analysis: A Comment on Weiss and White*, 76 CALIF. L. REV. 1015, 1042-45 (1988). *See also* R. BRYANT, *supra* note 17, at 129.

165 For the new rules see *Admission of Securities to Listing*, at § 7 (Nov. 1984), issued by authority of the Council of the Stock Exchange.

166 *See* FitzSimons, *EC Directives Change Securities Markets*, Fin. Times, Feb. 15, 1990, at 37, col. 1.

167 On the factors which may influence the development of financial centers see C. KINDLEBERGER, ECONOMIC RESPONSE: COMPARATIVE STUDIES IN TRADE, FINANCE, AND GROWTH ch. 4, at 134 (1978) (predicting "very tentatively" that Brussels would eventually be the EC's financial centre). For a suggestion that businesses will not become involved in regulatory arbitrage see Price Waterhouse, *Banking and Securities Regulation in Europe: A Survey of Senior Management Views* (1990).

The method of coordination which the Community has adopted will not inevitably result in competitive deregulation. It is possible that some institutions would consider that the investor and depositor confidence which would result from regulation under a strict system could outweigh the competitive advantage provided by regulation under a relaxed system. A Member State could market its regulatory system as a system of tough and effective regulation designed to promote investor confidence. This phenomenon is the "struggle to the top".[168] Some Member States apply rules stricter than those of the relevant EC Directives and there are signs of a reluctance to weaken these rules.[169] The International Stock Exchange in London has recently begun to market a listing in London as a product which can ensure investor confidence,[170] although it simultaneously relaxed its rules. It is a small step from marketing an investment market to the marketing of an entire regulatory system.

It is clear that each Member State will have an interest in developing its own system as the leader of the EC regulatory systems for financial services, and in making its system the most popular. The possession of such a system would provide considerable advantages to that Member State in terms of revenue and employment if financial services firms were to carry on business in that Member State. These advantages are the foundation for a serious conflict between the interest of that Member State as part of the Community and its own national interest.[171] These

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168 For the view that the state corporate legal systems protect shareholders see, e.g., Winter, *supra* note 163, at 276: "so long as the capital market is concerned, it is not in the interest of management to seek out a corporate legal system which fails to protect investors, and the competition between states for charters is generally a competition as to which legal system provides an optimal return to both interests"; Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers*, 57 TEX. L. REV. 1, 28-29 (1978); Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J. L. ECON. & ORG. 225 (1985) (an empirical study of reincorporation and competition between the states); Romano, *The Political Economy of Takeover Statutes*, 73 VA. L. REV. 111, 121-22, 189 (1987); Macey & Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469 (1987); Easterbrook, *Antitrust and the Economics of Federalism*, 26 J. L. & ECON. 23 (1983); Baysinger & Butler, *The Role of Corporate Law in the Theory of the Firm*, 28 J. L. & ECON. 179 (1985).

169 *See, e.g.*, Dept. of Trade and Industry, *Disclosure of Interests in Shares: The EC Major Shareholdings Directive. A Consultative Document* 4 (Feb. 1991) ("In the United Kingdom, Part VI of the 1985 Act already contains provisions on the disclosure of interests in shares which are in most respects stricter than those in the Directive. The Government believe that the UK should continue to impose stricter requirements.").

170 The International Stock Exchange, *A Listing in London* (undated pamphlet on file with author). *See also* Fin. Times, Feb. 15, 1990, at 3, col. 4 (recent advertisement for NASDAQ: NASDAQ "offers. . .the proven efficiency, liquidity and regulatory standards of a screen-based electronic market").

171 Coordination of national laws is supposed to involve the adjustment of national law so that solutions are adopted which take account of national interests and also of the interests of other Community partners, a real change in the national law-making process. *See* Vogelaar, *The Approxi-*

problems are not new, and they are not unique to the EC. The ongoing discussion about Delaware's race to the bottom in the context of corporate law in the United States provides food for thought in the European context.

However, the parallel is not exact, because EC legislation covers areas reserved to the states in United States law when it provides for minimum standards in relation to corporate law, in addition to covering matters which are regulated in the United States by federal securities laws. In the United States, it is possible to remedy defects in the corporate law of the states through federal securities rules, and to ensure that states adopt a single interpretation of federal law. EC legislative provisions do lay down minimum standards, but there are weaknesses in the EC mechanisms for ensuring compliance by Member States with their EC obligations, and for ensuring comparable interpretations of provisions of EC legislation in different Member States.

Thus, the debate about whether the states are racing towards the lowest possible level of corporate law in the United States, and about possible solutions to this problem, if it exists, may not be directly relevant to the EC's single market in financial services. There may be significant differences between the market for corporate law and the market for investor and depositor protection rules. Even if Winter is correct in saying that investors can ensure the existence of the corporate law regime which protects their interests,[172] it is not clear that the same argument would apply to the market for investor and depositor protection rules. Shareholders are not entirely reliant on the protection provided by corporate law, partly because they enjoy some protection by market forces. The market for corporate control may, for example, provide protection for shareholders in companies with inefficient managements.[173] There is,

mation of the Laws of Member States under the Treaty of Rome, 12 COMMON MKT. L. REV. 211, 211 (1975).

172 *See* Winter, *supra* note 163.

173 *See, e.g.*, Manne, *Mergers and the Market for Corporate Control*, J. POL. ECON. 110 (1965); Manne, *Some Theoretical Aspects of Share Voting*, 64 COL. L. REV. 1427 (1964); R. MARRIS, THE ECONOMIC THEORY OF 'MANAGERIAL' CAPITALISM (1964); Fama & Jensen, *Agency Problems and Residual Claims*, 26 J. L. & ECON. 327 (1983); Fama & Jensen, *Separation of Ownership and Control*, 26 J. L. & ECON. 301 (1983); James, *An Analysis of the Effect of State Acquisition Laws on Managerial Efficiency: The Case of the Bank Holding Company Acquisitions*, 27 J. L. & ECON. 211 (1987); Fischel, *supra* note 168, at 1; Leebron, *Games Corporations Play: A Theory of Tender Offers*, 61 N.Y.U. L. REV. 153 (1986); Easterbrook & Fischel, *Corporate Control Transactions*, 91 YALE L. J. 698 (1982); Dann & De Angelo, *Corporate Financial Policy and Corporate Control: A Study of Defensive Adjustments in Asset and Ownership Structure*, 20 J. FIN. ECON. 87 (1988); Comment, *Two-Tier and Negotiated Tender Offers. The Imprisonment of the Free-riding Shareholder*, 19 J. FIN. ECON. 283 (1987); Jensen & Ruback, *The Market for Corporate Control: The Scientific Evidence*, 11 J. FIN. ECON. 5 (1983).

however, no market-based equivalent to investor and depositor protection rules, because those rules are intended to remedy market failures.[174]

B. Ending the Race?

It was not always inevitable that the EC would choose to regulate financial services in the way that it has. For example, commentators have suggested that there should be an EC Securities and Exchange Commission.[175] It has been suggested that, although powers could be given to the national authorities, it was "seriously worth considering whether the primary implementation by national authorities should not be supplemented by a subsidiary power of intervention on the part of a community organ".[176] The introduction of an EC supervisory authority with responsibilities in the financial services sphere would help to ensure that rules would be applied in the same way in all Member States. The draft EC legislation which is designed to achieve the single market in financial services would make the Commission responsible for exercising supervisory functions, but it is doubtful whether the Commission has the resources necessary to perform this function given the wide range of its responsibilities.

Although there is no Euro-regulator for financial services, the EC is aware of the risks of competitive deregulation within the single internal market in financial services. The preamble to the Second Banking Directive states that Member States should not authorize banks which appear to be trying to avoid the stricter rules of another Member State.[177] However, the Recital expresses no more than a pious hope, because the operative provisions of the Directive do nothing to force the supervisory authorities in the Member States to turn away banks applying for author-

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174 *See, e.g.*, Gordon, *Ties That Bind: Dual Class Common Stock and the Problem of Shareholder Choice*, 76 CALIF. L. REV. 1, 68-69 (1988).

175 *See* Hopt, *Report*, 13 COMMON MKT. L. REV. 245 (1976).

176 *Id.* at 250. *See also* Leleux, *Corporation Law in the United States and in the EEC*, 5 COMMON MKT. L. REV. 133 (1967-68) (suggesting the need for a European agency responsible for securities regulation based on the American model).

> [H]armonization presents very great difficulties when the actions of the authorities in the various countries are based on different ideas, and even if harmonization is achieved, the disadvantages of having parallel but multiple procedures that have to be gone through are obvious.

Id. at 159.

177 Second Banking Directive, *supra* note 14, at Recital 8 ("the principles of mutual recognition and of home Member State control require the competent authorities of each Member State not to grant authorization or to withdraw it where factors such as the activities programme, the geographical distribution or the activities actually carried on make it quite clear that a credit institution has opted for the legal system of one Member State for the purpose of evading the stricter standards in force in another Member State in which it intends to carry on or carries on the greater part of its activities.") *Cf.* Proposed Investment Services Directive, *supra* note 56, at Recital 4.

ization. This hope will not avert a race to the bottom in the single market in financial services, and, if such a race does occur, resulting in the development of one or more financial centers in the EC, it is unlikely that future harmonization of regulation within the EC could reverse this development.

IV. Conclusion

The EC rules which are designed to create the single internal market in financial services are the basis of an important attempt to develop common approaches in countries with diverse economic and social environments, and the conclusion of the rules is an impressive achievement. However, there are weaknesses in these rules: the EC still relies too much on territorial concepts which are no longer appropriate to modern financial markets; there is too much scope for individual action by the Member States, which could interfere with the development of the single market; and the single market may become a market in which lax regulatory standards prevail. These weaknesses have two sets of implications. First, Member States will still, after 1992, be able to impose rules within their own territory which affect firms authorized to carry on business in other Member States and may act as a barrier to entry. Second, the terms of the EC's Directives may give rise to competitive deregulation of financial services within the EC, so that only the minimum standards imposed by those Directives prevail. There is considerable doubt whether the minimum standards set out in the Directives are sufficient.