The european union banking law essay sample

Economics

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Europe's financial services sector is rapidly developing. Universal banks, investment banks, insurance companies, `bancassurance' conglomerates, card issuers and payment systems, back offices and front offices – all are affected. And the pace of change is accelerating. One of the agents of change is Europe's much debated and sometimes derided new currency – the euro. Whatever foreign exchange traders may think of the euro, Europe's financial world knows the impact on financial markets has been fundamental and irreversible. Of course, technology and globalisation sit alongside the euro as drivers of change. But for Europe the euro is an additional and unique factor (Patel 35).

Since the euro zone currencies were transformed into denominations of a single currency on 1 January 1999, the euro has captured approximately 40% of the international bond market. Private sector bond issues are increasing rapidly by market value, and newly admitted companies raised over 130 billion euros in European markets in 1999, more than twice the 1998 figure. All these changes require improvement of EU Banking Law (Erhard 32-34).

In May 1999, The European Commission put forward a host of ambitious policy objectives and specific measures for improving the Single Market for financial services in the EU over the next five years. The Commission stresses the importance of completing this Financial Service Action Plan (FSAP) by the 2005 deadline, especially in light of a recently-commissioned study that suggests integration of financial markets could add 0. 5%-0. 7% annually to the EU's GDP (Brash 17). The Commission also says that an integrated well-functioning home market will improve the global

competitiveness of EU financial service providers and attract more foreign investors. It will also strengthen the international role of the Euro.

As well as this legal requirement, the Commission has been asked by the Member States to align the Directive with the Financial Action Task Force on Money Laundering (FATF)'s " Forty Recommendations". Consequently, the Commission proposal is likely to cover terrorist financing, shell banks, referrals, politically-exposed persons, issues regarding the introduction of clients, transparency and beneficial ownership. The forty recommendations have provisions on customer due diligence and record-keeping, for example, stipulating that financial institutions should not keep anonymous accounts or accounts under obviously fictitious names. They also urge countries to align their laws with the 2000 United Nations " Palermo" Convention on organised crime – an instrument the EU has signed up to but which has not yet been ratified by all Member States (Brash 18-19).

FATF is the inter-governmental body that sets international standards on money-laundering. All fifteen of the " old" EU Member States are among its 33 members, as is the European Commission. The body's first set of recommendations from 1990 focussed heavily on drug-related money-laundering. However, following the September 11, 2001 terrorist attacks on the USA, FATF's mandate was expanded to cover terrorism. The new recommendations, adopted in 2003, are described by FATF as " a comprehensive framework for combating money laundering and terrorist financing" (Edelman & Bagel 55).

Since the FSAP was adopted, a number of changes to the financial and political climate have caused the Commission to re-think its strategy slightly and call for tougher regulation in Europe. The terrorist attacks on the United States last September shook the insurance sector, and called into question whether existing EU rules on insurance solvency are sufficient to protect policy-holders. Financial scandals that have dogged the US recently – such as the collapse of Enron and WorldCom – have prompted calls for tougher legislation in Europe to prevent such incidents happening on this side of the Atlantic (Edelman & Bagel 56-58).

It was taking longer than expected to reach a deal on a new streamlined Directive on prospectuses for entry to stock exchanges, in part because of concern that the proposed legislation may not be tough enough. The Commission originally hoped to have the new Directive adopted by the end of 2002, but political wrangling among Finance Ministers suggests that final approval now looks more likely in 2003. In particular, recent scandals in the US financial sector have shifted the context of the debate, and prompted calls from such political heavyweights as Hans Eichel, the German Foreign Minister, that the new Directive should contain tougher laws to protect the interests of retail investors (Shaw & McGuire 38-39).

The CCBE (Council of Bars and Law Societies of the European Union) feels " it would have been wiser" for the Commission to assess what impact the 2001 Directive has had before proceeding with a further revamp, a spokesman said on June 22. The lawyers' lobby is quite critical of the Second Directive because of the wide margin of interpretation it gave the Member States over its implementation. (Edelman & Bagel 59-62).

The spokesman added that many of the Directive's reporting obligations go against the client's right confidentiality with their legal counsel. He added that the CCBE, which had meetings with the Commission on the third Directive, is not expecting these issues to be raised in the new proposal and that its focus will remain narrow. The organisation is still assessing whether the FATF obligations on reporting suspicious transactions are stricter than those of the 2001 Directive. The EU legislation notably allows lawyers to maintain professional secrecy with their clients if they are defending them in a legal proceeding (Edelman & Bagel 62).

The European Commission has mentioned two related projects in its Communication of March 29, 2004 that it adopted in response to the March 11 Madrid train bombings (COM/2004/221). The first is a study to be carried out in 2004 on the need for EU legislation to oblige each Member State to register all bank accounts. The second is a debate to be launched also in 2004 on improving the transparency of corporate bodies to prevent them becoming infiltrated by terrorists or organised criminals (Shaw & McGuire 38-41).

The new Directive, which replaces two previous Directives (80/390/EEC and 89/298/EEC), was tabled by the Commission in May 2001. It aims at making it easier to raise capital across borders by providing a single EU passport, and removing the need for companies to publish separate prospectuses (the disclosure document containing all the necessary information to enable investors to make a correct assessment of the assets and liabilities of publicly-traded bonds and shares) in each EU market.

Before the end of the year 2004, the European Commission hoped to put forward a proposal for new legislation on the information that publicly-traded companies must disclose. The contents of the proposal will draw on the two rounds of consultation that the Commission has recently held. Internal Market and Financial Services Commissioner Frits Bolkestein believes that, in light of the Enron scandal, the need to improve market transparency for investors all over Europe is imperative (Shaw & McGuire 42).

The Commission hoped that the new Directive on market abuse will be adopted before the end of 2002. It put forward new proposals for a Directive on insider dealing and market manipulation in May 2001, setting out common rules against market manipulation throughout Europe in order to strengthen investor confidence in these markets. The European Parliament gave its Opinion on the draft Directive on March 14, 2001 and the Council adopted its common position on July 19, 2002.

The new Directive seeks to replace a previous Directive on insider dealing (89/592/EEC) which was adopted more than a decade ago. The Commission argues that new rules are needed because some EU Member States have weak provisions or none at all, leading to a patchwork of regulations and hindering the creation of an integrated financial market.

The Commission is planning to put forward proposals for a substantial shake-up of the current Investment Services Directive (93/22/EEC) before the end of 2002, based on wide-ranging consultations it has held over the past two years. The Commission hopes that the new Directive will be adopted by mid-2003. The review will concentrate on two key areas: affording greater

protection to investors and guaranteeing the provision of cross-border services by investment companies (Mayan 43).

The Commission will report to the Council in December on how the May 1998 Settlement Finality Directive (98/26/EC) has been put into practice. The Directive entered into force on December 11, 1999 and the Commission says all Member States have now implemented it (Mayan 44-45). The Directive aims to reduce the systematic risk associated with payment and securities settlement systems, especially the risk linked to the insolvency of a participant in such a system. To this end, the Directive contains provisions for cross-border orders, insolvency proceedings, and collateral security (Smith 45-49).

The Commission has been trying to get a new Directive on takeover bids adopted for almost 13 years, and is still having problems. The latest revision of the Takeovers Directive was put forward by the Commission in November 1997 and amended by Conciliation Committee in June 2001. The Directive aims at establishing a level playing field for takeover bids in all EU Member States (Mayan 47). It also seeks to provide protection for shareholders by establishing minimum requirements for the conduct of such bids. But some Member States, especially Germany, argue for greater flexibility on the defensive measures that a company may use to frustrate a takeover bid (Smith 52-58).

The European Parliament, under pressure from Germany, rejected a compromise agreement on the Takeovers Directive in July 2001. Following this surprise rejection by MEPs, a group of experts, chaired by Jaap Winter,

was set up to try and negotiate a new compromise deal that would be satisfactory to all parties. The Winter Group presented its first report on the Takeovers Directive at the beginning of this year. A second report is due to be published in September 2002, and will address issues such as cross-border voting, capital maintenance, and the functioning of companies. Commissioner Frits Bolkestein says that he hopes to be able to come forward with a revised proposal soon after the expert group’s next report.

The European Commission has been having some difficulty getting a new Directive on cross-border company mergers adopted, but following the adoption in 2000 of the European Company Statute is optimistic that a solution can be found in the next year or so.

A Commission proposal on a new Directive to facilitate cross-border mergers between public companies established in different Member States (the so-called 10th Company Law Directive) was tabled as far back as 1985. But the proposal has been blocked for a long time now over the issue of worker participation – the right of workers to have a say in important decisions taken by the company likely to affect the workforce. The Commission expects to table a new proposal in September – with a view to getting it adopted in 2003 – that takes account of the solutions agreed at the Nice Summit in December 2000 for the European Company Statute (Patel 36-38).

Also in the context of the European Company, the Commission is planning on putting forward a proposal for a 14th Company Law Directive before 2003. This Directive will concern the transfer of companies’ registered headquarters between Member States. It will draw on a report from a Group

of High Level Company Law Experts and decisions that are still awaited from the European Court of Justice.

The Commission is optimistic that the Council and the European Parliament will adopt a new Directive on occupational retirement pensions before the end of the year. The aim of the Directive, which was tabled in October 2000, is to create a prudential framework to ensure a high level of protection for the rights of future pensioners. The principal new element of the proposal is that professional pension institutions will be able to manage cross-border schemes. Finance Ministers reached political agreement on the new Directive on June 4 of the last year, taking into account lessons learnt from the Enron scandal (Stone 33-34).

In April 2001, the Commission issued a Communication on " the elimination of tax obstacles to the cross-border provision of occupational pensions", calling on all Member States to eliminate discrimination against occupational pension schemes established in other EU countries. The Commission would like in particular to see an end to situations of double taxation and double non-taxation. These conditions can occur when an EU citizen works in one Member State but retires in another. In this case, an individual may find that he is taxed on pension contributions whilst he is working, and then again on the emerging benefits he receives after he retires.

After the last summer, the Commission had to consider what steps need to be taken to make clearance and settlement procedures in the EU's financial markets more efficient. This follows on from a wide-ranging consultation that

was launched on June 3 and is due to run until the end of August (Stone 34-35).

Clearing and settlement are the procedures by which transactions in securities and derivatives are finalised. The Commission believes that efficient clearing and settlement procedures are essential in allowing market participants to operate effectively in an integrated EU financial market. The Commission indicates two main objectives: removing barriers to the finalisation of individual cross-border transactions and removing any competitive distortions that prevent market forces from delivering a more efficient infrastructure for cross-border activity.

A follow-up to the out-of-court settlement system FIN-NET, which was first launched on February 1, 2001, was launched. FIN-NET is a network of 35 national ombudsman schemes, mainly targeting the banking and insurance sector. The main purpose of the network is to solve more commercial disputes outside of the courts, especially in cases where the service provider is established in a different Member State to the consumer. The follow-up will include: publication and dissemination of a brochure in order to better inform the wider public, further widening of the geographical and sectoral coverage, further improvement of information and co-operation between schemes (Stone 37-39).

The Commission is aiming to put forward a proposal for a new EU capital framework – i. e. the amount of capital which supervisors require financial institutions to hold in order to cover adequately the risks to which they are exposed – in early 2004, with a view to its implementation by the end of

2006. The Commission plans to carry out a further impact study of the proposed reform starting in October 2002. A third consultative document should be published in early Summer 2003.

The EU executive feels the capital framework needs to be revised because regulations increasingly fail to capture the risks that banks and investment firms are undertaking and also that the current regime was failing to deliver adequate incentives for prudent risk management. To this end, the Commission hopes to deliver " a refined risk based focus for capital allocation requirements while maintaining minimum levels of capitalisation and continuing to promote competitive equality" (Smith 58).

European harmonisation is the most significant factor affecting international banking trade in the EU. The adjustment of banking standards, supervisory regulations, collateral requirements and product specifications not only force change on established systems and structures but also drive international comparisons. This creates benchmarking opportunities for internationally aware clients, and additionally opens the whole market for cross-border selling (Colton 89).

Innovative new technologies such as telephone and Internet-based banking have, of course, played a crucial part in the development of banking law. The acceptance of telephone-based transactions over the past five years has made most branch visits redundant. In the coming five years the borderless medium of the Internet will completely remove the national limitations of banking markets. This transparency, provided by the new Directive, will allow the customer a clear view of what is on offer and permit easy access to

what they want, at the same time will provide strict money management control. That in turn will place considerable competitive pressure on the banks to perform not on a national basis, as in the past, but at an international level (Colton 91-93).

Additionally the inherent move toward internationalisation of the marketplace will create scope for efficiencies and further threaten the position of the weaker players. Players which do not have the capacity to take a strong international position will inevitably suffer from a more limited international understanding and higher costs than their internationalised competitors. These market conditions are likely to result in a second shake-out of the weaker players.

In the banking sector, those discount brokers who offer a very limited transactional service must question how they add value. The introduction of advanced, secure transaction mechanisms on the Internet is well positioned to replace them at a fraction of the cost. Successful players in this niche must take this new form of competition into account and adapt to survive. Setting up a centralised unit has the advantages of scale and coherence of managing the whole system from one location. The ability to locate in a low cost area will drive down costs and centralised management will create efficiencies. However, such a strategy distances the bank from its international clients. It is also questionable whether the international linguistic and socio-cultural expertise is readily available in one location for such a major undertaking (Mullins 18-23).

One of the principal problems facing internationalisation is the data protection laws in individual countries. Before the Directive 95/45/EU came into full effect, the amount of data that was transferable from country to country remained limited. New Directive guidelines therefore were discussed in the hope they will replace the national laws on a truly European level (Mayan 51-54). Processing data in a third country can also be a hindrance to work efficiency; the best will however provide innovative solutions whilst waiting for the bureaucratic machinery to catch up. Citibank, for example, has been able to process all of its European Visa card transactions in South Dakota, based on a contractual agreement that ensures the protection of the data.

The Commission hopes that a new Directive on financial conglomerates, such as the big bancassurance groups, can be formally adopted without difficult by Parliament and Council before the end of the year, following political agreement reached by EU Finance Ministers on May 7. The new Directive seeks to stamp out inconsistencies between sector-specific financial legislation that opens up loopholes and opportunities for circumventing the rules. It will introduce new prudential supervision rules for credit institutions, insurance companies and investment firms that have their head office in the EU and are part of a financial conglomerate (Stone 42).

The Commission is in the process of defining a new solvency framework for EU insurance companies, which it hopes to complete by the end of 2005. The first phase of reviewing the insurance solvency system (so-called Solvency I) concentrated on improving the existing rules for the calculation of the solvency margin requirement. In the context of Solvency I, the Council

adopted two new Directives in February this year aimed at reinforcing safeguards for policy-holders by strengthening the solvency margin requirements for life and non-life assurance undertakings (Herman & Rogan 81-83).

The second phase (Solvency II), which is now under way, is a more wide-ranging review that considers more sophisticated approaches to solvency. It will examine inter alia: the rules governing the assets and liabilities of insurance undertakings, the matching of assets to liabilities, reinsurance arrangements, and the implications of accounting and actuarial policies. The objective will be to match solvency requirements better to the true risk encountered by an insurance undertaking and to encourage insurers to improve their measurement and monitoring of the risks they incur (Herman & Rogan 84).

More stringent rules for insurance undertakings are considered necessary to deal with unforeseen events such as, for example, the terrorist attacks of September 11. Although insurance firms put aside a prudent sum of money to cover liabilities, this amount can prove insufficient when such circumstances cause claims to be much higher than expected. The solvency margin provides an extra source of capital to help meet unexpected events and thus protect the policyholders of an insurance undertaking (Herman & Rogan 87-92).

The Commission is also looking into the possibility of creating a harmonised supervision framework for reinsurance, which it is considering aligning with the work of the Solvency II proposal. The investigation was initiated at the

start of 2000 and will continue until 2003. The Commission emphasises the importance of a solid system of reinsurance supervision in light of the September 11 terrorist attacks last year.

And a new Directive on a common market for insurance mediation was expected to be adopted by Council and Parliament before the end of the year 2004. The principal aim of the Directive is to guarantee that an insurance intermediary registered in one country can provide services in other Member States, and therefore seeks to establish common rules for registration.

The Action Plan on preventing fraud and counterfeiting in non-cash payments, which was launched in February 2001 and is currently being implemented, is set to run until the end of 2003. After this point, the Commission will prepare a report on its implementation and propose further measures, if needed (Smith 59-61).

The Action Plan called on retailers to better protect their websites from data hacking, recommends introducing a toll-free telephone number to enable prompt notification of loss or theft of payment instruments, and invites network operators to develop systems to alert holders when their electronic payment instruments are being used.

The Commission intends to put forward a proposal for a third Directive on money-laundering before the end of 2003. In light of the September 11 attacks on the US, this new Directive is likely to be specifically targeted at the financing of terrorist activities (Smith 62).

Two money laundering Directives have already been incorporated into EU law. The first Directive (91/308/EEC) sought to prevent misuse of banks and other financial institutions for laundering of criminal funds, primarily those related to drug trafficking. The second money laundering Directive (2001/97/EC), due to be implemented 28 June 28, 2003, extends the provisions laid out in the first one. It covers a wider range of serious crimes than drug trafficking, including terrorism, trafficking in armaments, human beings, antiques or human organs, prostitution, fraud, illegal gaming, kidnapping, blackmail and robbery. It also covers additional activities and professions which are not necessarily linked to the financial community – such as casinos, auditors, real estate agents and the legal professions when carrying out financial transactions on behalf of their clients (Mayan 53-54).

One of the other " wider conditions for an optimal single financial market" mentioned in the FSAP progress report is the long-stalled Directive on the taxation of savings income, which the Commission now hopes can be adopted by the end of 2002. The first proposal on savings taxation was put forward in 1989, and aimed at introducing a common withholding tax. This was subsequently withdrawn in favour of a 1998 proposal which sought to create a co-existence model whereby Member States could choose whether to levy a withholding tax or to exchange information on income received by account-holders, particularly non-residents. This approach failed, too (Stone 43-45).

In 2001, the EcoFin Council came up with a political compromise which all but dropped the withholding tax aspect. The focus of the latest proposal is largely on exchange of information between Member States on savings

income earned by non-residents. However, the Directive does include a transition period of seven years during which time Austria, Belgium and Luxembourg can impose a withholding tax on the savings income in question. After this period, all Member States should have in place an information exchange system. Any tax should be levied in the country of residence.

Until recently there was very much an attitude of business-as-usual, particularly in the securities area. Parameters were national, with occasional forays into the global arena but with Europe regarded often as an annoying distraction. The speed of developments regarding exchanges and settlement systems in particular has shaken these assumptions, and left regulators scrambling to catch up. It has also left many private sector players frustrated by the obstacles which nationally oriented rules place in the way of cross-border activities, as well as by the plethora of overlapping and competing supervisory bodies to which they must answer (Erhard 35-37).

Before developing this point there is one aspect of supervisory concern which should be mentioned – market stability. At international level the G7-backed work of the Financial Stability Forum has led to reports on Highly Leveraged Institutions, Capital Flows, and Offshore Financial Centres, with the main themes of: closer regulatory oversight, stricter disclosure rules, and improved transparency (especially for liquidity risk of the public and banking sectors in relation to short-term capital flows). At European level, finance ministers – urged on by the European Parliament – have also felt it appropriate that in this environment of rapid change they should look again at crisis management mechanisms for dealing with systemic risk in a single

European financial market (Fischer 21-22). Their conclusions have not suggested any major hole in the system, though the report they commissioned (the `Brouwer Report') did raise one controversial point – the potential role of the European Central Bank (ECB) as a limited `lender of last resort'. Broadly, work on this subject has so far suggested that the integration of financial markets in Europe in itself creates no notable new systemic risks, and that Europe should march in time with broader global developments on these issues (Patel 36-38).

However, the work has also underlined the importance of a well-functioning market infrastructure to ensure effective market allocation of capital, based on correct price signals and good information. The New Directive highlighted the importance of clear rules concerning responsibilities of different supervisors, both within EU states and across borders between them. On both of these last two points Europe has some work to do in a rather short time.

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