OPTIONAL INSTRUMENTS FOR THE INTEGRATION OF THE EUROPEAN FINANCIAL MARKETS

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ABSTRACT

Il contributo passa in rassegna gli strumenti di legislazione comunitaria che non sono destinati ad armonizzare le legislazioni nazionali, ma a fornire un regime giuridico opzionale in grado di essere utilizzato in tutta l'Unione Europea. Esso descrive: (a) alcune fattispecie esistenti, quali la Società europea e la Società cooperativa europea; (b) alcuni progetti in corso, quali la Società mutua europea e i progetti per la normativa contrattuale europea; (c) alcune iniziative del mercato attualmente esaminate a livello Comunitario, quali l'ipoteca europea (Euromortgage), il Pan-European Trust Instrument, per la costituzione di fondi fiduciari, e il Pan-European Direct Debit Scheme; (d) alcuni strumenti opzionali creati dagli operatori del mercato finanziario e sostenuti dal SEBC, come STEP (Short-Term Euro Paper) e EMA (European Master Agreement). Lo studio comprende anche talune valutazioni critiche sulla tecnica in parola: viene ricordato come una metodologia simile esistesse anche all'inizio del Mercato comune nel contesto della libera circolazione delle merci, allorché i produttori, desiderosi di evitare le barriere tecniche nazionali alla vendita pan-europea, potevano scegliere di adottare le numerosissime specifiche comunitarie. Questa prassi onerosa terminò con la sentenza "Cassis de Dijon", che consentiva le vendite pan-europee. Nel contributo si sostiene che, piuttosto che seguire la strada del 26° regime, dovrebbe essere realizzata una giurisprudenza simile (che al momento non esiste) per permettere la vendita pan-europea di prodotti finanziari a seguito dell'autorizzazione dello Stato membro di origine. Viene anche suggerito che le Società europee dovrebbero poter utilizzare i prodotti finanziari pan-europei, invece di essere costrette a frammentare sul piano nazionale le proprie attività finanziarie. Si rammenta, infine, che nulla ostacolerebbe gruppi di Stati membri, ad esempio i paesi dell'area dell'euro, che volessero agevolare l'integrazione dei rispettivi mercati, attraverso una legislazione concertata che istituisca strumenti opzionali uniformi.

I INTRODUCTION

Beyond its primary objective of achieving and maintaining price stability, the European System of Central Banks (ESCB) is legally bound by its secondary objectives, as defined in Article 105 of the Treaty establishing the European Community ("the Treaty"), to *"support the general economic policies in the Community with a view to contributing to the achievement of the objectives of the Community"*. One of these Community objectives[1] is the establishment of a common market, which, following the abolition and prohibition of internal exchange controls in the early 1990s, encompasses the internal market for financial services and markets.[2] Monetary unification in 1999 removed the last barriers for financial integration, namely exchange risk and trading under different units of account. The construction of a common and integrated financial market has been defined by the European Council and by the Council of Ministers on repeated occasions as a priority for Community action.[3] As the ESCB is an organisation created by the Law, it must act as determined in its constitutive charter: all its actions that are compatible with its primary monetary policy objective are legally bound to aim at fulfilling the secondary objectives as well, of which financial integration is paramount.

Disregarding legal reasoning, the achievement of an integrated financial market is also in the interest of the Eurosystem: it is bound to carry out 'single' policies in 12 (and soon more) financial market environments, in which the potential for asymmetries and distortions is relatively high. The more integrated the financial markets become, the more homogeneous the performance and the effects of the Eurosystem's single policies will be.

At the end of 2004, the members of the Governing Council of the ECB elaborated and adopted a "Eurosystem Mission Statement" that is consistent with the above.[4] After recalling its primary objective, the Statement reads: *"Acting also as a leading financial authority, we aim to safeguard financial stability and promote financial integration"*.[5]

The Legal Committee of the ESCB has on numerous occasions dealt with matters related to the integration of financial markets in Europe. From a legal perspective, and given that financial services and markets are a highly regulated area, the objective of achieving a single internal market for financial services

1 See Article 2 of the Treaty.

2 Capital movement restrictions within the European Community were abolished in Stage I of Economic and Monetary Union (EMU) by way of secondary legislation, and at primary law level by the Maastricht Treaty. See Articles 51 (2) and 56 (1) of the Treaty.

3 For example, the European Council, Cologne, June 1999 stated that it *"considers rapid progress in this [single market for financial services] area to be essential"*. Other examples include: the European Council, Lisbon, March 2000: *"It is essential to exploit the potential of the euro to push forward the integration of EU financial markets"*; the European Council, Stockholm, March 2001: *"Rapid implementation of the Financial Services Action Plan is of the utmost importance"* (this summit approved the Wise Men's Report (the "Lamfalussy methodology")). The European Council, Barcelona, March 2002, similarly stated that it *"reaffirms its strong commitment to achieving fully integrated securities and risk capital markets by 2003 and financial services markets by 2005"*.

4 Available at www.ecb.int

5 Author's emphasis.

is a challenging one. It encompasses technical complexity as well as policy and political issues. At the political level, the overall aim of integrating financial markets, which has been repeatedly and clearly stated by the supreme Community bodies, seems to be contradicted at lower levels by the staunch protection extended by the authorities of the Member States to their national financial centres.

The approach followed to create a single internal market for financial services has relied on the traditional Community method: minimal harmonisation by way of Directives. And indeed, this is what existed at the start of Monetary Union: minimal harmonisation, and a whole array of differing rules in the Member States, whereby host countries have sometimes generously used the "general good" concept to protect their own local markets.[6]

The establishment of eight regulatory or advisory committees[7] (also known as the "comitology" procedure) covering all sectors of financial services, following the methodology recommended by the Committee of Wise Men on the Regulation of European Securities Markets[8], is a heavy-handed and burdensome mechanism when it comes to catering for the needs of today's financial services. The legislative process is still slow and the success of such a methodology remains to be seen. The Community institutions are considering their strategy for the next decade, and should ensure an intelligent implementation of the Lamfalussy comitology procedure. While a sectoral comitology structure may satisfy the technical expertise needed to regulate financial services, three aspects need to be considered: (i) the inbuilt conflict of interest owing to the national composition of these committees, leading to the need for compromise solutions; (ii) the enhancement of diversity as a result of the maintenance of the instrument of Directives rather than Regulations[9]; and (iii) the tendency to keep 'Level 1' legislation extremely detailed, rather than limit it to framework principles. The maintenance of generic "general good" exceptions to the free provision of financial services, plus an even greater application of the subsidiarity principle, does not seem to be the most efficient model for achieving market integration.

This article does not dwell on legal harmonisation, which is the task of the comitology procedure described above. Nor does it advocate maximum, rather than minimum, harmonisation. Instead, it points to a different methodology aimed at facilitating financial integration via the creation of pan-European regimes which are non-mandatory for market participants. It proposes that the

6 "General good" rules, as an exception to the general principle of free provision of services, should be used restrictively by Member States; any use with the disguised aim of protecting local markets would qualify as being incompatible with the Treaty.

7 The Financial Services Committee (FSC), European Banking Committee (EBC), Committee of European Banking Supervisors (CEBS), Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), European Insurance and Occupational Pensions Committee (EIOPC), European Securities Committee (ESC), Committee of European Securities Regulators (CESR), and European Financial Conglomerates Committee (EFCC).

8 *Final Report of the Committee of Wise Men on the Regulation of European Securities Markets,* Brussels, 15 February 2001. The procedure was initially limited to just the securities markets.

9 Directives entail national implementation, which produces diversity in the detail; Regulations do not require national implementation, and thus preserves equal rules throughout the EU.

Community institutions should provide market participants with the option of using financial instruments that benefit from a "European passport", i.e. ones that can be used equally throughout all 25 Member States, if necessary by way of a Community legal act or with the support of Community bodies. Such instruments would not need the prior harmonisation of national laws, but would instead represent an additional option on top of the financial instruments already covered by national legislation. Participants in financial markets, i.e. investors, lenders, borrowers, issuers, etc., could choose to use such instruments throughout the 25 Member States, in parallel to their right to keep using the nationally regulated financial instruments. This methodology has sometimes been named a "26th regime"[10].

2 OPTIONAL INSTRUMENTS CREATED BY COMMUNITY LAW

2.1 THE EUROPEAN COMPANY

Thirty-one years after it was first conceived[11], the European Company Statute[12] (SE) was finally adopted on 8 October 2001, and entered into force in October 2004. In its Preamble, the SE states that it aims at facilitating the incorporation and management of companies with a European dimension without the impediments of having to deal with differences in national company law.

The incorporation of a European company is optional. National companies with pan-European activities may continue to be incorporated under national law, but Regulation 2157/2001 provides for the right, when its conditions are fulfilled, for the company's shareholders to convert the company into a European company. In the case of a new company, the Regulation permits its founder members the option – but without any obligation – to adopt the SE or to incorporate under national law.

Moreover, the solution provided by Regulation 2157/2001 to the old debate as to whether a European company should have a two-tier or a one-tier board system, which paralysed the adoption of the Regulation for many years, is to offer greater freedom to its shareholders. It is the shareholders, and not the Member States, that can decide in favour of either of the two models. The preservation of employees' rights is ensured by the accompanying Council Directive[13], which regulates employee involvement in company affairs.

Because of the rights of establishment and the freedom to provide services, any company incorporated in a Member State may in principle trade throughout all

10 Meaning a regime that is different to the regimes of the 25 Member States, optional to them and applying throughout the EU.
11 The first proposal of the Commission for a Regulation on the Statute of a European Company dates back to 1970.
12 Council Regulation (EC) 2157/2001 of 8 October 2001 on the Statute for a European Company (SE) (OJ L 294,10.11.2001, p. 1).
13 Council Directive 2001/86/EC of 8 October 2001 supplementing the Statute for a European Company with regard to the involvement of employees (OJ L 294, 10.11.2001, p. 22).

25 Member States. Therefore, the benefit of having a European company is relatively limited. Its greatest advantage is the legal capacity to transfer the seat of the company anywhere in the European Union (EU) without changing its statute or affecting its legal personality, capacity and ongoing activities. This benefit will however be extended to nationally chartered companies once the draft 14th Company Law Directive on the Transfer of Seat is adopted and implemented.

The initial design of the European company as an optional instrument for business participants with pan-European activities was indeed valuable. However, the above objective has been only partially achieved, since Regulation 2157/2001 is not a comprehensive set of company law rules, and foresees[14] that whenever matters are not regulated in the Regulation itself, the loophole will be filled by the national company law of the registered seat of the European company. Moreover, the Regulation contains a non-discrimination provision[15], whereby a European company is to be treated in exactly the same way as a public limited liability company in each of the Member States. This means that, for better or worse, a European company is also affected by national company law, since it cannot be put into a position of advantage or disadvantage with regard to national public companies. Thus, both the law of the seat and the law of each of the Member States in which a European company performs its activities have an influence on its corporate status.

Regulation 2157/2001 is indeed an imperfect legal construction, the result of compromise. It will take time to see how attractive the European company is, and may perhaps lead to future reforms designed to improve the attractiveness and use of this optional instrument. However, in the financial sector, a major multinational banking group has recently announced its consolidation into an SE.[16]

2.2 THE EUROPEAN COOPERATIVE COMPANY

The initiative to set up an European Cooperative Society, which was first suggested by the European Parliament back in 1983[17], finally succeeded in 2003, when the Council adopted the Statute for a European Cooperative Society (SCE).[18] Its objective is identical to the aims of Regulation 2157/2001, and the Preamble of Regulation 1435/2003 mirrors several paragraphs of Regulation 2157/2001. Its constituent membership needs to be *"physical persons resident in different Member States or legal entities established under the laws of different Member States"*; it also allows for the creation of a European cooperative society

14 Article 9.

15 Paragraph 5 of the Preamble and Article 10.

16 Nordea, a financial conglomerate with banks in Sweden, Finland, Denmark, Norway and Poland; insurance companies in Finland, Denmark, Norway and Poland; and asset management activities based in Sweden, announced this at the High-level Conference held in Brussels on European Financial Integration: Progress & Prospects, on 22-23 June 2004. Nordea is the result of a cross-border merger that took place in 2001 between Merita Bank (Finland), Nordbanken (Sweden), Unibank (Denmark) and Christiania Bank og Kreditkasse (Norway).

17 OJ C 128, 16.5.1983, p. 51.

18 Council Regulation (EC) 1435/2003 of 22 July 2003 on the Statute for a European Cooperative Society (SCE) (OJ L 207, 18.8.2003, p. 1).

in order to merge branches or subsidiaries of a cooperative when these are located in a Member State other than the state of their head office. The SCE has as its principal objective "the satisfaction of its members' needs and/or the development of their economic and/or social activities".

Similar to the SE, an SCE is governed by the Council Regulation, by its by-laws, by the laws of the Member States on cooperatives, and by the consequences of an "equal treatment" rule[19] that preserves a level playing-field between the SCE and the national cooperatives.

Cooperative banks represent a fairly sizeable percentage of the EU banking sector. Thus, this optional instrument could potentially cater for the needs of those cooperative banks whose business extends beyond national boundaries.

3 OPTIONAL INSTRUMENTS IN THE PROCESS OF BEING CREATED BY COMMUNITY LAW

3.1 THE EUROPEAN MUTUAL SOCIETY

The European mutual society is a relatively old project[20] which is conceptually similar to the European Company Statute. It aims at providing an optional instrument for the establishment of a mutual society with a multinational membership that carries out cross-border business. Employees' rights are safeguarded and harmonised by way of a supplemental draft Directive on the involvement of employees.

A European mutual society requires a minimum membership of two persons, either physical or legal, resident or with a seat in two or more Member States. It may also be established by domestic pre-existing societies when there is a relevant cross-border dimension in the business carried out by its members at the time of its incorporation. The European mutual society has legal personality, and the draft regulation provides for basic corporate rules. The draft regulation does not affect compulsory social security schemes managed in some Member States by provident mutual societies.

The proposal had its first reading in the European Parliament in 1993[21], and was overall supported. The insurance and pensions industry is currently urging the Council and Parliament to go ahead with the proposal. However, building societies, despite being mutual institutions that are active not only on the retail (mostly mortgage-related) side but also on the money market, derivatives and other wholesale markets, are unlikely to see any advantage in the European mutual society until pan-European (mortgage) products may be marketed.

19 Articles 8 (2) and 9 of the Regulation.
20 The Commission proposal dates from 18 December 1991 (COM (91) 273/5 and 273/6 final (OJ C 99, 21.04.1992, pp. 40 and 57)).
21 OJ C 42, 15.02.1993, pp. 114 and 120.

Nevertheless, the existence of this optional instrument may serve as a way round the current barrier of different mutual company laws in the Member States, which hampers the entrance of foreign companies to national markets.

3.2 EUROPEAN CONTRACT LAW

The harmonisation of contract law in Europe has been the subject of extensive analysis and valuable investigation by several groups of academics.[22] In 1989 and in 1994 the European Parliament adopted two resolutions[23] calling for the Commission to start work on a European code of private law. Following this, in 2001 the Commission submitted for public consultation a Communication on European Contract Law[24], in which several options were offered to deal with diversity in national contract law. In 2003 the Commission issued an "Action Plan" on "More Coherent European Contract Law"[25], which was discussed in a joint Conference of the Commission and the European Parliament, together with representatives of so-called stakeholders of EU contract law.[26] Finally, in 2004 the Commission outlined in a Communication[27] the details of its plan to offer an optional contract law instrument to market participants.

The proposed Action Plan abandons the idea of full harmonisation of contract law and, among other actions, recommends the preparation and adoption of an "optional instrument, which would provide parties to a contract with a modern body of rules particularly adapted to cross-border contracts in the internal market". It aims to "facilitate considerably the cross-border exchange of goods and services", enabling parties to refer to this instrument instead of "insisting on the necessity to apply one party's national law". Such an optional instrument would be embedded either "in a regulation or a recommendation, which would exist with, rather than instead of, national contract laws". It would widen the parties' contractual freedom, so that "they would only choose the new instrument if it suited their economic or legal needs better than the national law which would have been determined by private international law rules as the law applicable to the contract."[28]

With regard to the difficult issue of coexistence of the optional instrument with mandatory rules, for instance those on consumer protection, the Commission's proposal seems to point to including the necessary mandatory provisions within the optional instrument, thereby avoiding the current diversity of national laws in this regard. However, the Communication cautiously states that this is a matter for further reflection.

22 See the material and bibliography included in A. Hartkamp et al., *"Towards a European Civil Code"* (The Hague: Kluwer Law International, 1998); J. Basedow, "A Common Contract Law for a Common Market", CML Rev. (1996), p. 1196; J. Basedow, *Quel droit privé pour l'Europe* (Brussels: Bruylant, 2003); *L'harmonisation du droit des contrats en Europe*, Colloque, sous la direction de C. Jamin and D. Mazeaud, *Economica* (2001); or W. van Gerven, "Harmonisation of Private Law: Do We Need It?", CML Rev. (2004), p. 505, etc.

23 OJ C 158, 26.6.1989, p. 400; OJ C205, 25.7.1994, p. 518.

24 OJ C 255, 13.9.2001, p. 1.

25 OJ C 63, 15.3.2003, p. 1.

26 EU institutions, Member States, the ESCB, financial services, consumer organisations, industry, and the legal professions.

27 "Droit européen des contrats et révision de l'acquis: la voie à suivre", COM (2004) 651 final, 11.10.2004.

28 Paragraphs 90, 91 and 92 of the Commission's Communication.

The elaboration of the optional instrument will first require a prior step, namely the definition of a 'common frame of reference', with the initial aim of helping the EU institutions to achieve consistency when legislating on contractual issues, as well as of becoming "a point of reference by national legislatures inside the EU", in order to "diminish divergences between contract laws in the EU".[29]

The Commission has recognised the complexity and importance of this project by pointing to a horizon of 2009 as the target date for the adoption of this optional instrument.[30]

4 SOME MARKET PROPOSALS FOR COMMUNITY ACTION TO CREATE OPTIONAL INSTRUMENTS

4.1 THE "EUROMORTGAGE" AND THE PAN-EUROPEAN TRUST INSTRUMENT

In March 2003 the Commission set up the Forum Group on Mortgage Credit (FGMC), an industry advisory group with a mandate to identify and assess barriers to the integration of this part of the financial industry and to make recommendations to abolish such barriers. On 13 December 2004, the FGMC published its first report[31], which constitutes a very valuable analytical piece in the framing of further policy towards financial integration. It contains 48 recommendations that the Commission has committed itself to assessing and translating into specific policy measures by the middle of 2005.

For example, recommendation 38 announces that "The Commission should explore the concept of the Euromortgage, for example by way of study, to assess its potential to promote EU mortgage credit markets integration." And recommendation 39 states: "The Commission should encourage Member States to increase the transferability of mortgages by introducing pan-European Security Trust instruments."

The "Euromortgage" is also an old concept.[32] However, unlike past designs, the FGMC report does not aim at harmonising national mortgage laws, but rather at creating an optional instrument that will run in parallel with national mortgages. Its introduction would require changes in national legislation, in order to create the option for borrowers either to mortgage their real estate under national mortgage law, or alternatively to use a pan-European mortgage that may serve as

29 Ibid., paragraph 60.

30 The time horizon for the adoption of the "common frame of reference" was announced as 2007.

31 Available at http://europa.eu.int/comm/internal_market/finservices-retail/home-loans/index_en.htm

32 The Commission had already prepared a report (the "Segré Report") back in 1966 which advocated the harmonisation of national laws on mortgage and mortgage-backed securities. In 1984 the Commission submitted a proposal for a Directive on the freedom of establishment and the free supply of services in the field of mortgage credit; however, this did not finally see the light of day (COM (84) 730 final; OJ C 42, 14.2.1985, p. 4). In 1987 the Union du Notariat Latin elaborated and submitted to the Commission a draft uniform law regulating the "eurohypothèque". These initiatives are analysed in O. Stöcker, "L'Eurohypothèque", *Revue Banque et Droit* 49 (1996), or in H. G. Wehrens, "Reflections on a Euro-mortgage", in A. Hartkamp et al., *"Towards a European Civil Code"* (The Hague: Kluwer Law International, 1998). More recently, in 1995 the General Assembly of the European Mortgage Federation advocated the idea of developing an optional regime in the field of consumer mortgage credit which would benefit from a 'European passport' (see J. L. Duplat, Rev. *Droit Bancaire* 1 (1996), p. 99).

collateral for credit obtained either at home or from foreign lenders, or to cover the issuance of asset-backed securities that may be marketed on a cross-border basis. To achieve this objective, the FGMC report suggests the use of either Directives or Regulations, with the aim of allowing a similar optional financial instrument in all Member States, the so-called Euromortgage, the character of which is outlined in paragraph 117 and Annex VI of the FGMC report.

The pan-European Trust Instrument is defined as a legal construction that allows "a single bank to hold mortgage collateral on trust for all the banks participating in the credit agreement". The idea behind this is that the Common Law concept of "trust" should be made optionally available in all 25 Member States for the specific purposes of the mortgage credit market, so that a single mortgage (or a plurality of mortgages in favour of one bank) may be financed by a syndicate of lenders on a cross-border basis, and mortgage-backed loans can be traded on a cross-border basis. Although the FGMC report does not specify how this could be achieved, the establishment of such optional instruments would clearly require Community legislation.

4.2 INSURANCE AND OCCUPATIONAL PENSION PRODUCTS

The Commission set up four expert groups[33] in October 2003 to assess the state of financial integration following the almost completed adoption of the legislative measures foreseen in the Financial Services Action Plan (FSAP).[34] In June 2004, the Commission organised a high-level conference[35] on "European Financial Integration: Progress and Prospects" to discuss inter alia the assessment report of each of the four expert groups. The four reports[36] are extremely interesting and provide an array of ideas on how to advance financial integration; this paper refers below to only one of these, the report of the Expert Group on Insurance and Pensions.

Following an explanation of the very "disparate nature of the barriers" to the cross-border sale of insurance and pension products, and the extremely marginal amount that such sales represent, the Report of the Expert Group on Insurance and Pensions inter alia recommended:

- *studying the development of a 26th regime;*
- *encouraging business to develop pan-European products; and*
- *adopting the statutes for a European mutual society.*

The reference to a 26th regime is explained in the Report as an "optional EU regime governing essential parameters" of insurance and pension products, in order to "facilitate the marketing of pan-European products on an EU scale."

The development of pan-European products is also explained in the Report: "Given the wide diversity of new national rules in the pensions area, some feel

33 On Banking, Asset Management, Securities Trading & Investment, and Insurance.
34 COM (99) 232 of 11.05.1999.
35 Palais d'Egmont, Brussels, 23-24 June 2004.
36 The four reports are available at: http://europa.eu.int/comm/internal_market/en/finances/actionplan/stocktaking.htm

that the evolution of a pan-European pension product based on a 26th regime was the only viable way forward in the short term."

Finally, the last indent refers to the European mutual society statute, as mentioned earlier in this paper. The Report limits itself to stating that "the statutes for a European mutual society should be finally adopted."

4.3 THE PAN-EUROPEAN DIRECT DEBIT SCHEME

The European Payments Council (EPC) is an industry body that was established by the three main European banking associations[37] at the start of the twenty-first century to represent the payment systems industry and to interface with the central bank community and with EU legislators. In September 2002 the EPC decided to launch a project with the aim of devising a harmonised scheme for direct debit, namely an instrument that allows instructions by clients to debit their bank accounts to be implemented on a cross-border basis. On June 2004, the EPC adopted a Resolution with the parameters of the Pan-European Direct Debit (PEDD) scheme, and which reads: "it appears unrealistic to harmonise the numerous and very different existing national schemes in order to enable customers and banks to effect in the same way euro direct debit transactions throughout the Single Payments Area; […] a new instrument can coexist in parallel with unchanged national schemes during a transitional period and is the fastest way to launch the implementation of the PEDD; […] the new instrument is to process both cross-border and national direct debit transactions". The resolution also contains the parameters of the PEDD, including the criterion that "the migration of payment flows [from national schemes to the PEDD] will be market-driven."

The PEDD project is an example of a 26th regime, a market-driven, harmonised scenario. The EPC resolution indeed acknowledges that "the full implementation of the PEDD scheme" will require "the removal of all national and EU legal and regulatory barriers."

5 OPTIONAL INSTRUMENTS CREATED BY MARKET PARTICIPANTS AND SUPPORTED BY THE ESCB

5.1 THE SHORT-TERM EURO MONEY MARKET PAPER (STEP) INITIATIVE

The initiative to create an optional instrument for short-term euro money market paper (STEP) came from the financial market itself[38], in view of the heterogeneous standards and practices currently prevailing in the fragmented and asymmetric

37 European Banking Federation, European Savings Banks Group and European Association of Cooperative Banks. See EPC documents on its website: www.europeanpaymentscouncil.org

38 The *Association Cambiste Internationale* (ACI) – The Financial Markets Association (FMA). The European Financial Markets Lawyers Group (EFMLG), a group of lawyers from the EU banking sector working on the harmonisation of market practices in Europe, assisted the ACI-FMA in the implementation of this project. A public consultation by these market groups was responded to by many market participants. The Committee of European Securities Regulators (CESR) and the EU Commission also attended some of the organising meetings as observers.

short-term money market paper, and with the aim of fostering its development in those Member States where such a market is either marginal or non-existent. The legal vehicle to establish this optional instrument is through a market convention that market participants have to adhere to in order to benefit from the STEP label. This convention standardises the eligibility conditions for short-term securities to obtain the STEP label, the eligibility of issuers to issue under that label, the minimum amounts of the papers, and the disclosure of information and the format of the documentation. It also sets the rules for the electronic settlement of instruments issued in book-entry form under the programme, establishes the provision of data to the ESCB for the production and publication of statistics, and regulates a STEP Market Committee with the capacity to grant the STEP label to those issuance programmes that comply with the market convention. The STEP label does not refer to the financial soundness or creditworthiness of the issuer, or to the liquidity of the assets, or the accuracy, completeness or truthfulness of information provided in the STEP information memorandum.

The ESCB's support of this market initiative became apparent in the Governing Council decision of 22 July 2004, according to which the ESCB would assume a clearly defined limited role consisting of the collection and publication of yield indices and of statistical data on market activity, as well as the provision of some technical assistance to the STEP Market Committee. This support was requested by numerous banks, issuers and trade associations in view of the neutrality, pan-European capacity and independence of the ESCB.

All of the features foreseen in the market convention aim at avoiding a situation whereby the STEP instruments are covered by the requirements of the Prospectus Directive. This part of mandatory law is thus not applicable. However, the limits of market action are shown by the fact that other existing national rules, including regulatory and/or supervisory regimes, with regard to short-term securities will continue to apply. The optional instrument is therefore subject to marginal national legal differences.

5.2 THE EUROPEAN MASTER AGREEMENT

At the start of Economic and Monetary Union in January 1999, one of the barriers to the successful integration of the secured euro money market and of the (re-denominated into euro) bond markets was the absence of one single common market documentation. No less than 15 market standard agreements[39] were in use in those markets, implying considerable diversity in the legal background of trades conducted with the same single currency, with risks linked to discrepancies between different agreements applying to connected transactions.

39 PSA/ISMA GMRA 1995, Italian Annex to GMRA 1995, Netherlands Annex to GMRA 1995, TBMA/ISMA GMRA 2000, Italian Annex to GMRA 2000, Netherlands Annex to GMRA 2000, PSA/ISMA 1995 Supplemental Terms and Conditions for Belgium, *Rahmenvertrag für echte Pensionsgeschäfte 1997, Rahmenvertrag für Wertpapierpensionsgeschäfte 2002, Convention-cadre relative aux operations de pension livrée,* Convention-cadre relative aux operations de marché à terme, *Acuerdo-marco para operaciones financieras,* AEB, ISDA Master Agreement 1987, ISDA Master Agreement 1992, ISDA Master Agreement 2002. In addition, for central banking market operations, each national central bank had its own terms and conditions (within the "minimum common features" established by the Governing Council of the ESCB in 1998).

For this reason, the three main European banking industry associations[40] prepared an optional instrument for use by wholesale market players in both domestic and cross-border trades, named the European Master Agreement for Financial Transactions (EMA), which was launched on 17 July 2001.[41] The 2001 version was enhanced on 29 January 2004 with the addition of a "Product Annex for Derivative Transactions".

The EMA entails a single legal regime for a wide variety of wholesale transactions.[42] It is therefore an alternative to not only the different national standards, but also the several 'international' master agreements that are product-specific.[43] It is a multi-product agreement which allows for cross-product netting.

This single legal regime is also multi-jurisdictional. Before launching the EMA, the sponsor organisations obtained legal opinions to ensure the validity and enforceability of the EMA in most EU Member States and in Switzerland. Thus, and in contrast with the "international" master agreements which are actually subject to either English or New York law and jurisdiction, the EMA may be subject to the law and the jurisdiction[44] of many European States, including all euro area Member States. For this reason, the EMA is available in many European languages. The implementation of Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements[45] should ensure the validity and enforceability of the EMA in all 25 Member States.

The use of the EMA by market participants operating in several EU jurisdictions provides another advantage: a single EMA executed by the head office would cover the transactions undertaken by its branches. Until now, branches located in different Member States have had to use the local standard documentation, with the result that a single legal person would need several market standards to document as many agreements as the jurisdictions where it operates by way of branches. The EMA, on the other hand, is a multi-branch agreement and economises in this respect, providing a consistency that beforehand did not exist. However, the EMA does not go so far as to cover in a single agreement the trades of subsidiaries, as it does not permit cross-affiliate netting.

The ESCB began to support this market initiative in 2001 when the Governing Council decided that the ECB would use this optional instrument for all its repo operations with its EU and Swiss foreign reserves and own funds counterparties.

40 European Banking Federation, European Savings Bank Group and European Association of Co-operative Banks.
41 Available on the website of the sponsoring organisation, at www.fbe.be
42 Repurchase ("repo") transactions, securities loans, currency swaps, foreign exchange spot transactions, forward transactions, put and call options on financial assets and on commodities, interest rate swaps, cap, floor and "collar" transactions, and combinations and variants of these.
43 TBMA/ISMA Global Master Repurchase Agreement, ISDA Multi-currency Cross-border Master Agreement, the Overseas Securities Lending Agreement, Global Master Securities Lending Agreement, TBMA Cross-product Master Agreement and ISDA Cross-bridge Agreement.
44 Contrary to other pre-existing master agreements, the EMA contemplates the possibility for arbitration, and while allowing full freedom to the parties to organise such arbitration, it foresees two arbitration institutions, the European Centre for Financial Dispute Resolution and the International Chamber of Commerce. Speeded-up procedures, technical expertise and confidentiality are strong arguments in favour of the arbitration option.
45 OJ L 168, 27.6.2002, p. 43.

The Governing Council decided in March 2005 to also use the EMA for the ECB's derivative operations in 14 EU jurisdictions and in Switzerland. The changeover from existing master agreements to the EMA was swiftly carried out. The ECB continues to use pre-existing standard documentation with counterparties located outside the EU and Switzerland.

With regard to other ESCB members, as of June 2005, the central banks of Austria, Belgium, France, Ireland and Malta have also decided to use the EMA, while the other EU central banks are considering the use of this optional instrument. According to sponsoring organisation sources, the two financial markets in which the EMA is most extensively used are those of Germany and France.

6 CRITICAL REMARKS

6.1 GENERAL COMMENT

This article has focused on an approach to financial integration that avoids or bypasses the need for legal harmonisation. By introducing optional pan-European vehicles and products, financial trades may indeed overcome some national barriers through the use of legal vehicles that have a pan-European 'passport'; by these means, market players may foresee economies of scale commensurate with the new dimension of EU financial markets. The approach is indeed neither 'hard' law harmonisation (in the sense that national legal diversity persists) nor 'soft' law (in the sense that once market participants decide to use it, it becomes legally effective and binding). In this it resembles the American example of the Uniform Commercial Code, a set of uniform rules that both contractual parties in their contracts, and State legislators in their law-making, may choose to adopt or follow, but are otherwise not legally binding.

This paper examines a model for market integration in the financial sector that has until now received insufficient attention by European policymakers. Optional instruments are however not new in the Community's history. In the establishment of a common market for goods, several legal acts in the 1960s and 1970s provided producers with the option either to follow national technical requirements, or to adopt standards harmonised by Community legal acts.[46] The Court of Justice's "Cassis de Dijon" judgement[47] made redundant the extensive practice of optional harmonisation: the mutual recognition of national standards sufficed thenceforth for the free circulation of goods. As stated in the Commission's Communication following that landmark judgement: *"Any product lawfully produced and marketed in one Member State must, in principle, be admitted to the market of any other Member State"*.[48]

46 See the section on "Optional harmonization" in P. J. Slot, "Harmonization", EL Rev. (1996), p. 383, which provides examples and a bibliography.
47 Case 120/78, *Rewe-Zentral AG* v. *Bundesmonopolverwaltung für Branntwein* [1979], ECR, p. 649.
48 Commission Communication concerning the consequences of the judgement of 20 February 1979 ('Cassis de Dijon'), OJ C 256, 3.10.1980, p. 2.

The achievement of a single market for financial services would similarly require its own Cassis de Dijon jurisprudence to ensure that financial services lawfully provided and marketed in one Member State are admitted to the market of any other Member State. This would make the use of optional instruments redundant, as it did for the free circulation of goods, and would require a profound revision of the "general good" exception in the financial *acquis*, limiting its scope and with a European control mechanism. It would also represent an enhancement, beyond purely prudential supervision aspects, of the competences of the home Member State vis-à-vis the host Member State, so that financial services and products marketed in the company's home state may also be marketed throughout the EU.

Although some jurisprudence of the Court of Justice has pointed in the direction of the Cassis de Dijon jurisprudence in the domain of financial services[49], financial products cannot so far be marketed throughout the Community, unlike commodities. The recent Caixabank case[50] does not go as far as the Cassis de Dijon jurisprudence, although it questions whether the "general good" exception used by France to justify its prohibition to foreign banks to market in France a financial product marketed – in this case – by Caixabank in Spain is sufficient to limit the freedom of establishment foreseen in the Treaty. It reaches the conclusion that in this particular instance, this is not the case. In this sense, the Caixabank judgement also represents a positive step forward and gives some hope that the Cassis de Dijon jurisprudence will spill over into the financial services.

Unless a similarly radical approach is followed to the one outlined above, it will take many years before the EU can reach the promised land of an integrated financial market by following either the path of legislative harmonisation through the Lamfalussy methodology, or that of optional pan-European instruments. Experience shows that Member States tend to see optional instruments rather like Trojan horses, seeking to introduce harmonisation by default.[51] The resistance to the European Company and similar pan-European vehicles, and the requirement that no discrimination provisions be included in such vehicles, show that Member States are not ready to admit competition between their national laws and pan-European standards. Member States seem to prefer the difficult path of approximation of laws, namely through the comitology procedure, whereby they can influence the outcome, to competition with a pan-European optional instrument. Market participants, on the other hand, would wish to operate under maximum freedom, including the optional use of instruments that have a pan-European reach. This article aims at least to submit for renewed debate the potential use of pan-European optional instruments as a tool for fostering financial integration.

49 See comment on the ECJ Judgement of 25.7.1991 on Case C-76/90 Säger in L. Roeges, "L'exercice de l'activité bancaire dans le domaine de la prestation des services" Rev. (belge) de Banque (1996), p. 303; and A. Gkoutzinis, "Free Movement of Services in the EC Treaty and the Law of Contractual Obligations Relating to Bank and Financial Services", CML Rev. (2004), p. 119.

50 Case C-442/02, *CaixaBank France* v. *Finance Ministry*, judgement of 5 October 2004.

51 The expression is taken from W. Blair and R. Brent, "A Single European Law of Contract?", *European Business Law Review* 15 (2004), p. 20 ("Those who are opposed to a European code will carefully review these proposals [the optional instrument], lest a Trojan horse is admitted by default").

6.2 OPERATIONAL INSTRUMENTS FOR PAN-EUROPEAN SOCIETIES

As already described in this article, Community law has provided or is about to provide the option for pan-European vehicles (i.e. the European company, a European cooperative society and a European mutual society). However, it remains to be seen whether they will be successful in reality. So long as these European vehicles need to operate under national rules, there seems little incentive for entities to use them. A pan-European credit institution wishing to benefit from one of these optional vehicles will find that it cannot offer the same financial products throughout the Community, and nor will it be able to raise funds homogeneously in its area of operation. Moreover, its deposit guarantee scheme will differ from Member State to Member State.[52] Pan-European vehicles currently need to adapt their operations to the national rules of each jurisdiction in which they operate.

This article submits that the option of using such entities would be promoted if the Community enabled the use of pan-European instruments – for instance, the possibility to use a Community-regulated single deposit guarantee scheme, or to issue securities[53], offer deposits, consumer loans, life insurance policies or occupational pension products under a single framework. This would require the Community to design and adopt additional optional instruments, which may exist in parallel to national rules.

6.3 THE INTEGRATION OF THE EURO AREA

Optional instruments do not necessarily need to be adopted by the Community. A group of Member States seeking to facilitate the further integration of their financial markets could coordinate the adoption of multi-jurisdictional optional instruments by way of national rule-making, enabling these instruments to be mutually recognised and operative within their markets. The start of the third stage of Economic and Monetary Union on 1 January 1999 and the disappearance of currency barriers for the integration of the financial markets of the participating Member States has arguably entailed the emergence of a business case with regard to optional rule-books that would facilitate the integration of financial services within the single monetary area. The cross-border consolidation of markets or of market infrastructures may be facilitated if adequate legal vehicles are made available to concerned parties.[54] Participating Member States should have a policy to provide participants with the legal instruments needed to achieve the economies of scale that Monetary Union makes possible. This paper contends that the technique of optional instruments – in addition to the more complex process of legal harmonisation in a community of 25 Member States – may usefully contribute to this end.

52 For instance, in the example of Nordea bank mentioned in footnote 16, one of the attractions of becoming a European company does not and will not materialise unless amendments are introduced to the current Community Directive governing the Deposit Guarantee Scheme for credit institutions that would allow for a single regime irrespective of whether the European company is operating in several jurisdictions.

53 It may be recalled that pan-European official banks such as the European Investment Bank (EIB), the European Bank for Reconstruction and Development (EBRD) or the ECB need to operate under national legal systems when they issue securities, and do not have a framework that enables them to operate under a single set of rules.

54 The business case for a single optional legal structure is supported by the existence of entities that functionally operate on a cross-border basis but are subject to several national rules, such as the Euronext stock exchange and the Euroclear and Clearstream securities settlement systems, etc..