THE LEGAL FRAMEWORK OF THE BANKING INDUSTRY IN THE EUROPEAN UNION

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Abstrakt v rodném jazyce
Práce usiluje o shrnutí a zhodnocení současné právní úpravy bankovnictví v Evropské unii. Její první část je věnována Evropské unii jako prostoru založeném na čtyřech základních svobodách, základním historickým a hospodářským souvislostem. Stěžejní část se zaměřuje na vlastní právní úpravu – primární, sekundární akty i relevantní judikaturu Soudního dvora

Klíčová slova v rodném jazyce
Volný pohyb kapitálu a plateb, bankovnictví, Evropský systém centrálních bank, první a druhá bankovní směrnice, směrnice o kapitálové vybavenosti bank, Basel II.

Abstract
This article attempts to summarize and assess the current regulation of banking in the European Union. Its first part introduces the EU as an area of four freedoms in historical and economic circumstances. The core part of the article is focused on legislation itself, providing the survey of primary regulation, secondary law acts as well as relevant case law of the European Court of Justice

Key words
Free movement of capital and payments, banking industry, European System of Central Banks, first and second coordinating directive, capital requirements directive, Basel II.

1. INTRODUCTION

Practically all the process of integration in Europe is attended by economically influenced efforts to harmonize and unify the law. The economic cooperation that had first started in the field of trade very soon called for administrative as well as legislative changes. The European market of today as a space with minimal barriers serves to benefit of the EU citizens and entrepreneurs. Deepening and fine-turning of the four freedoms aids achievements of economic growth, higher living standards and the position of Europe on the international field.

Special attention has been recently given to banking as a key industry enabling all the economic activities via depositing, crediting and arrangement of payments. Dealing directly with money, it must be considered as particularly sensitive realm which deserves preferential treatment. Although there is only meagre regulation of banking industry in the founding treaties, numerous secondary legislation have been adopted by the EU institutions to harmonize the national financial law of Member States.

This article attempts to summarize and assess the current regulation of banking in the European Union. Its first part introduces the EU as an area of four freedoms in historical and economic overview. The core part of the article is focused on legislation itself, providing the survey of primary regulation, secondary law acts as well as relevant case law of the European Court of Justice.

2. EUROPEAN UNION AS AN AREA OF FREE MOVEMENT OF CAPITAL AND PAYMENTS – HISTORICAL AND ECONOMIC BACKGROUND

The European Single Market comprises of territories of all Member States (MS) of the European Union. It is based on so call four fundamental freedoms – free movement of goods, workers, services and capital. Single Market has been formed as one stage of "European evolution" on the way from economic cooperation to political union, which is a distant aim of the European integration.

The notion of the free movement of capital includes most of all the field of liberalization of movement of capital, the field of payment systems and fight against money laundering. The main goal is to ensure cross-border payments and transfers and to lift all national obstacles for capital transfers among MSs and MSs and third countries.

It is the newest of all fundamental freedoms; it was fully achieved only after ratification of Maastricht Treaty in 1994, in connection with establishment of economic and monetary union. In fact, it supplements all the other freedoms and provides them with the essential technical framework. There is no effective free movement of goods if the payment methods for goods delivery are limited or even banned. Nor is there any free movement of workers if they cannot be easily paid for their work.

Since early 1960's there were attempts to liberalize direct investments, movement of short- and medium-term capital (commercial loans) and stock-exchange dealing. According to the ex-Article 67 of the ECT all capital movement restrictions as well as discrimination on any grounds were prohibited.

After the collapse of the Bretton-Woods system in 1971 foreign exchange restrictions were introduces and process of liberalization was discontinued till mid 80's. Several Member States only came up with unilateral measures of elimination of restrictions during that time. Single European Act (1987) meant the turning point back towards liberalization together with finalization of the single market, nonetheless, with transition periods for newly acceded countries and with safeguard clauses for large transfers allowed.1

In 1992, the Maastricht Treaty envisaged the creation of economic and monetary union based on single currency (the ECU at the time) by proclaiming common economic objectives and single monetary and exchange-rate policies.2 All the residual restrictions had to be removed. The guiding principles should have been stable prices, sound public finances and monetary conditions and a sustainable balance of payments (Art. 4/3) with the aim of an open market economy with free competition.

Operational provisions regarding the monetary union occupy the Title VII of the EC Treaty which, among others, sets the economic convergence criteria (Art. 121). In 1998 on legal basis of this Article, Council decided that the third stage of economic and monetary union (EMU) start[ed] on 1 January 19993 with eleven participating MSs (out of fifteen of that

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[1] For further details see Fact Sheets on European Union available at http://www.europarl.europa.eu/facts_2004 on 06/11/2008.

[2] Article 4 of the EC Treaty.

[3] Council Decision no. 98/317 of 3 May 1998 in accordance with Article 109j(4) of the Treaty, OJ 1998 L 139/30.

time). However, it was only a conversion unit, the euro coins and banknotes were not introduced until 2002.4 Since then, four other countries have introduced euro, including Cyprus, Malta and Slovenia (which accessed to the EU only in 2004); Slovakia shall join in 2009.

The institutional framework of the monetary union is represented by so called European System of Central Banks (ESCB) that is composed of the European Central Bank (ECB) and of the national central banks. The ECB's main task is to maintain the euro's purchasing power, and thus price stability in the euro area.

Regarding the banking industry, the free movement of capital stands as the precondition, however, the freedom to provide services and right of establishment are also closely related to the notion. Further the essay will focus on banking legislation in particular, concerning all its aspects.

3. LEGAL FRAMEWORK OF THE BANKING INDUSTRY IN THE EU

As introduced above, an open market with the free movement of capital and payments was an essential precondition for the further harmonization of regulation in the field of banking industry within the European Union.

It begs the question, however, while creation of area of free movement of capital is undoubtedly of public interest, and thus falls within the scope of European Community5 powers, does harmonization of banking law (i.e. private commercial law) also fall within EC's competence? Why is the further regulation necessary at all? Rather than interest of individual banks and customers, the protection of stability of the whole banking sector6 is at the stake. On the grounds of the European Court of Justice's well settled line of case law,7 let us set this issue aside and assume the EC has enough authority to legislate over banking industry.

3.1 PRIMARY REGULATION

The EC primary regulation in the founding treaties provides us only with principles and objectives as grounds for further legislation. Provisions of the EC Treaty on free movement of capital are based on presumption that the monetary union requires free movement of all capital transfers within the EC as well as with the third countries for its effective functioning. International (European) capital linkage shall serve as a tool of the integrated European single market to ensure competitiveness of the EU economy.

The free movement of capital comprises free movement of capital (FMC) in a narrower sense and free movement of payments (FMP). FMC may be defined as a cross-border financial

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[4] For further details see WEATHERILL, S., *Cases and Materials on EU Law*, 2006, pp. 317-318.

[5] It still must be distinguished between European Union as an umbrella organization and the European Community as a legal person endowed with the powers, rights and obligations. Nevertheless, this distinction will become irrelevant after the Lisbon Treaty comes into force. For simplification purposes, I occasionally use these terms promiscuously, where it is not crucial.

[6] For further details see MEJSTŘÍK, M., *Bankovní regulace (Banking Regulation)*, 2007, p. 4.

[7] Doctrine of implicit powers as judged in Commission v. Council, 22/70 [1971] ECR 263, and Cornelis Kramer and others, 3, 4 and 6/76, [1976] ECR 1279.

operation of establishment or enlargement of subsidiary, investment into real estate, contracting of loans or credit or operation with securities. FMP might be then understood as a cross-border transfer of money or other asset values for the purpose of an obligation fulfilment. Whereas, FMC always represents unilateral transfers, FMP stands for a part of a bilateral contract performance.8

Pursuant to the Article 56 ECT, any restrictions – either direct or indirect9 – on payments or capital movements are prohibited and abolished since 1994. The MSs are only allowed to set financial strictures in the field of taxation and the prudential supervision of financial institutions. Member States may also take adequate measures which are justified on grounds of public policy or public security (Art. 58).

Article 59 authorises the Council, acting by a qualified majority on a proposal from the Commission and after consulting the ECB, to take safeguard measures with regard to third countries if movements of capital to or from third countries cause, or threaten to cause, serious difficulties for the operation of economic and monetary union. The measures may be taken solely in exceptional circumstances. All these provisions have direct – both horizontal and vertical – effect.10

3.2 SECONDARY LEGISLATION

As mentioned, the banking industry is of a great importance, and thus of solemn interest of the MS. National governments are therefore very reluctant to waive their supervision over this field. Common legislative coordination may progress only at slow pace and it is rather "a patchwork" than comprehensive harmonization.11

The first harmonizing secondary act was the directive 73/183/EEC,12 adopted in 1973. As the name implies the directive prohibited all restrictions on freedom of establishment and freedom to provide services in respect of banks and other financial institutions, notably discrimination of foreign financial institution at undertaking business in another MS.

The following law acts may be categorized into two groups – harmonizing access rules and harmonizing protection and control rules.13 There are two directives belonging to the first category. So called the first coordinating directive14 defines minimal criteria of a bank

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8 Graziana Luisi and Giuseppe Carbone v Ministero del Tesoro, joined cases 286/82 and 26/83, [1984] ECR 377.

9 Legal concept of restrictions defined in Dassonville case, 8/74, [1974] ECR 837.

10 Seminal judgement by the ECJ – Van Gend en Loos, 26/62 [1964] ECR 1.

11 Further on harmonization of the law of banking transactions in Cranston, R., European Banking Law: The Banker-Customer Relationship, 1993, pp. 270-288.

12 Council Directive 73/183/EEC of 28 June 1973 on the abolition of restrictions on freedom of establishment and freedom to provide services in respect of self-employed activities of banks and other financial institutions.

13 For an overview of the EU financial law regulation see for instance Fact Sheets on European Union available at http://www.europarl.europa.eu/facts_2004 on 06/11/2008, or Wawrosz, P., Slováčková, P., Rizika a přínosy vstupu České republiky do Evropské unie z pohledu právního řádu (Risks and Benefits to the Czech Republic from the Accession to the European Union from the Legal Order Perspective), 2001, pp. 146-148.

14 First Council Directive 77/780/EEC of 12 December 1977 on the coordination of the laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions.

establishment and subjects it to national government control. The second coordinating directive15 is more complex and introduces the principle of a single Community authorisation (single licence). When a single licence is granted to a bank in its home MS it is allowed to pursue the banking business in any other MS throughout the EC. The host MS has supervision only over the branches within its territory.

The other group covers directives containing miscellaneous rules on protection and control in the banking sector, such as solvency, risk management and guarantees:

Own funds directive 89/299/EEC16 specifies the qualifying criteria for certain own funds items, however, the MSs remain free to apply more strict provisions,

Solvency ratio directive 89/647/EEC17 sets the solvency standards for financial institutions (proportions of weighted assets); it states the ratio shall be calculated on an individual basis by the national competent authority to protect depositors and investors in every particular case,

Large exposures directive 92/121/EEC18 harmonizes basic rules on supervision; a bank is considered to be at a large exposure if its value of exposure to a client or a group of connected clients is equal to or exceeds 10 % of its own funds,

Deposit guarantee directive 94/19/EC19 is focused on protection of depositors in the credit institutions in the EU by making guarantee schemes; it requires the minimum guarantee level at ECU [Euro] 20 000 which shall be paid by the reinsurance system of the home MS.

Consolidation directive 2000/12/EC20 is a comprehensive law act that aims at consolidated supervision as well as it groups all other key aspect of the legislation. The fight against financial crime is another big issue regulated by the EC secondary law. It was first introduced by directive in 1991 and amended ten years later in 2001.21 The directive requires MS to take appropriate measures against money-laundering (including information obligation) and set penalties.

Most recently, capital requirements directives22 have been adopted. The directives follow Basel II23 standards and set the minimum amount of capital of 8% held by a bank or a credit

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15 Second Council Directive 89/646/EEC of 15 December 1989 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions.

16 Council Directive 89/299/EEC of 17 April 1989 on the own funds of credit institutions.

17 Council Directive 89/647/EEC of 18 December 1989 on a solvency ratio for credit institutions.

18 Council Directive 92/121/EEC of 21 December 1992 on the monitoring and control of large exposures of credit institutions.

19 Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes.

20 Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions.

21 Directive 2001/97/EC of the European Parliament and of the Council of 4 December 2001 amending Council Directive 91/308/EEC on prevention of the use of the financial system for the purpose of money laundering – Commission Declaration.

22 Directive 2006/48/EC and 2006/49/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions.

institution, based on weighted risk. Similarly to Basel II, the directives have three-pillar structure. Besides capital adequacy rules, there is a requirement of supervision on individual basis and of market discipline. Due to the current financial crisis, the European Commission has reviewed the rules and in October 2008 presented an amendment to the directives. The proposal requires even higher amount of capital and suggests a new supervisory process for the EU banks.

This demonstration of the secondary legislation does not claim to be exhaustive. Notwithstanding, above mentioned directives, notably the most recent ones, might be considered to form the legal framework of banking industry in the European Union.

4. CONCLUSION

Bearing in mind the sensitivity of the banking industry and objectives of European Community, notably the functioning of the internal market, delicate treatment must be given to banking regulation. The Member States are not willing to give up their legislation power and supervision over the financial affairs. Nonetheless, current "crunch" on the financial markets requires measures, taken on international and supranational level, to prevent a domino effect in banking sector.

The article draws up a survey of past and current economic needs for development of the common banking industry legislation in the European Union. The principles and objectives as set by the EC Treat are deepening of four EU freedoms with the aim of effective and open market. There has been slow but continuous process of harmonization of national banking regulation via secondary law acts since 1970's. Recently, Basel II requirements has been adopted in a form of directive laying stress on three core pillars – capital adequacy, supervision and transparency.

There is always a question of how far can the harmonization go and what else may be shifted from the national to the supranational level of regulation. Would it be ever possible to come to a code of the unified substantive law?

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