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The Second Banking Directive of the European Economic Community and Its Importance for Non-EEC Banks

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Abstract

This article discusses the revised Article 7(4) of the European Communities' Proposal for a Second Council Directive on the Coordination of Laws, Regulations and Administrative Provisions Relating to the Taking-up and Pursuit of the Business of Credit Institutions. The article argues that the revision of the proposal for the Second Directive by the Commission of the European Communities will mainly have two effects. First, the Commission's review procedure will no longer be on a case-by-case basis, but on a country-by-country basis; the Commission will no longer interfere with an individual authorization procedure before the competent authorities of a Member State. Second, the suspension of future authorizations depends on a finding by the Commission that a specific country does not grant national treatment to EEC institutions; lack of reciprocity is no longer a basis for a denial of an application. This new approach will allow the Commission to defend against discriminations against EEC institutions abroad, while respecting different banking policies in third countries.

THE SECOND BANKING DIRECTIVE OF THE EUROPEAN ECONOMIC COMMUNITY AND ITS IMPORTANCE FOR NON-EEC BANKS†

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INTRODUCTION

On February 23, 1988, the Commission of the European Communities submitted to the Council of Ministers of the European Communities a Proposal for a Second Council Directive on the Coordination of Laws, Regulations and Administrative Provisions Relating to the Taking-up and Pursuit of the Business of Credit Institutions and Amending Directive 77/780/EEC (the "Second Directive").[1] A number of procedural steps are necessary before the proposed Second Directive becomes law in the European Economic Community (the "EEC" or "Community").[2] As it winds its way through the

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1. COM(87) 715 final, O.J. C 84/1 (1988) [hereinafter Second Directive].

2. The enactment of the proposed Second Directive requires the following steps: opinion of the European Parliament; opinion of the Economic and Social Committee; the Council's common position; second reading of the European Parliament; and finally, the adoption by the Council of Ministers. Treaty Establishing the European Economic Community, Mar. 25, 1957, art. 100, 1973 Gr. Brit. T.S. No. 1 (Cmd. 5179-II) at 37-38 (official English version), 298 U.N.T.S. 11, 54 (1958) (unofficial English trans.) [hereinafter Treaty of Rome]; Single European Act, art. 18, O.J. L 169/1, at 8 (1987). Directives do not, in general, have the force of directly binding law, but rather obligate the Member States to take appropriate measures to implement the provisions of the directives. Directives, therefore, as a rule have no effect for persons until the appropriate implementing provisions have been adopted by the Member States. Directives are intended to indicate the goal to be attained, but leave

political process, changes may be negotiated and the final Second Directive may vary from the proposed Second Directive. Nevertheless, it is the general conviction of bankers and lawyers in Europe[3] that the Second Directive will become EEC law in some form or other.

It is already clear that the Second Directive will profoundly affect the way in which banks will do business in the EEC principally in two ways: first, a common EEC banking market[4] will promote the growth of EEC banks and make them stronger competitors in the EEC as well as in the world market; second, non-EEC banks will have to obtain approval on the basis of reciprocity before they can do business on an EEC-wide basis. Since the Second Directive will make it more difficult for non-EEC banks to establish or acquire a banking subsidiary in the EEC while at the same time making it easier for EEC banks to compete in other Member States, it is important for non-EEC banks to be aware of the upcoming changes and to prepare themselves for the implementation of these changes before the restrictions of the Second Directive become effective.

This Article describes the principal provisions of the Second Directive and discusses how they will affect non-EEC banks.

I. *THE FIRST BANKING COORDINATION DIRECTIVE*

The First Banking Coordination Directive (the "First Directive"),[5] which was adopted in 1977, created the basis for the

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it to the Member States to set forth the manner in which this is to be accomplished. The obligation to implement a directive does, however, include an obligation to comply with the deadline that the directive prescribes. Common Mkt. Rep. (CCH) ¶ 4902.21.

3. "Europe" as used in this article means the EEC.

4. The banking market will be comprised of the countries that are members of the EEC ("Member States"). Member States are the following 12 countries: Belgium, France, Federal Republic of Germany, Italy, Luxembourg, Netherlands, United Kingdom, Ireland, Denmark, Greece, Spain, and Portugal. "EEC banks" and "EEC credit institutions" as used in this article mean credit institutions authorized as such in a Member State. For the definition of "credit institution," see *infra* note 30 and accompanying text.

5. First Council Directive of 12 December 1977 on the Coordination of Laws, Regulations and Administrative Provisions Relating to the Taking up and Pursuit of the Business of Credit Institutions (77/780/EEC), O.J. L 322/30 (1977) [hereinafter First Directive].

harmonization of banking laws in the EEC. Fifteen recitals in its preamble broadly identify the areas that the EEC considers the main targets for harmonization.[6] The recitals call for the enactment of legal provisions that roughly can be grouped into five categories: (1) rules abolishing barriers along Member State borders with respect to the provision of banking services, (2) rules providing for the freedom of EEC credit institutions to establish branches in other Member States, (3) uniform rules concerning essential authorization requirements for credit institutions, (4) uniform rules concerning essential supervisory standards, and (5) rules providing for (uniform) treatment of non-EEC credit institutions.

According to the First Directive, each Member State must require each credit institution to obtain an authorization in such Member State, as its country of origin, before commencing its activities.[7] The First Directive establishes certain minimum standards for such an authorization.[8] Freedom of establishment of branches, as understood by the preamble to the First Directive, means that a credit institution having its head office in one Member State does not need any additional authorization from another Member State when setting up a branch in that Member State.[9] The First Directive, however, takes only the first step towards the implementation of this goal. It does not prohibit a Member State from requiring that an EEC credit institution domiciled in another Member State obtain an authorization for the establishment of a branch in its territory;[10] but, it requires such an authorization to be granted on the basis of "national treatment," i.e., "subject to authori-

6. *See id.* whereas clauses, at 30-31.

7. *Id.* art. 3(1), at 33. "Authorization" is defined in the First Directive as "an instrument issued in any form by the authorities by which the right to carry on the business of a credit institution is granted." *Id.* art. 1, at 31.

8. *Id.* art. 3(2)-(3), at 33. The First Directive also provides that a credit institution that commenced business in accordance with the laws of the Member State in which it has its head office before the entry into force of the First Directive shall be deemed to be authorized. *Id.* art. 10(1), at 35-36.

9. *See id.* tenth whereas clause, at 31; *see also* Second Directive, *supra* note 1, art. 5(1), at 3 (eliminating the requirement of authorization by Host Member States for credit institutions authorized in other Member States).

10. *See* First Directive, *supra* note 5, art. 4(4), at 34 ("[T]he laws of Member States requiring a separate authorization for each branch of a credit institution having its head office in their territory shall apply equally to the branches of credit institutions the head offices of which are in other Member States.").

zation according to the law and procedure applicable to credit institutions established on their territory."[11]

The First Directive does not provide protection from protectionist or discriminatory measures of Member States in connection with the establishment and operation of branches of non-EEC credit institutions in Member States. Member States are merely obliged not to grant more favorable treatment to branches of non-EEC credit institutions than that accorded to EEC credit institutions[12] and to notify the Commission of all authorizations of branches of non-EEC credit institutions.[13] Nothing is said in the operative part of the First Directive about the establishment of *subsidiaries* of non-EEC credit institutions in the EEC.

The Second Directive, as will be shown below, contains provisions regarding the establishment of credit institution subsidiaries of non-EEC credit institutions[14] and also takes the final step towards full implementation of the freedom to establish branches of EEC credit institutions.[15] The First Directive, however, remains the principal source of EEC law regarding the establishment of branches in Member States by non-EEC credit institutions. In this respect, the First Directive will not be superseded by the Second Directive.[16]

II. *THE SECOND DIRECTIVE*

After the implementation of the First Directive, three obstacles to freedom of establishment of branches in other Member States still remain for EEC credit institutions. First, an EEC credit institution wishing to set up a branch in another

11. *Id.* art. 4(1), at 34; *see also supra* note 10.

12. *Id.* art. 9(1), at 35; *see also id.* art. 9(3), at 35 (giving the Community power to enter into agreements with a country outside the Community pursuant to which the Community may accord to branches of a credit institution from that country, on the basis of reciprocity, identical treatment throughout the EEC).

13. *Id.* art. 9(2), at 35.

14. *See infra* notes 122-31 and accompanying text.

15. *See infra* notes 57-63 and accompanying text.

16. *See* Second Directive, *supra* note 1, seventeenth whereas clause, at 2 (the procedures established in the First Directive "notably in relation to the authorization of branches of credit institutions authorized in third countries, should continue to apply to such institutions"); *see also* Comm'n of the European Communities, Proposal for a Second Council Directive, COM (87) 715 final, at I.1 (Feb. 16, 1988) [hereinafter Explanatory Memorandum] (explanatory memorandum accompanying the proposal for the Second Directive).

Member State still has to be authorized by the banking authorities of the host country; second, it remains subject to supervision by the host country and to restrictions in host country laws on the range of permitted activities; and third, in most Member States, branches have to be provided with earmarked "endowment capital," as if they were new banks.[17] All of these restrictions would be removed under the Second Directive by the end of 1992. Along with other accompanying EEC regulations in the banking sector (on own funds,[18] large exposures,[19] harmonized solvency ratios,[20] deposit-guarantee schemes[21]), the Second Directive is intended to:

—Remove the remaining barriers to freedom of establishment of branches; and

—grant full freedom to provide financial services throughout the EEC.[22]

The objective of the Second Directive is to create a truly internal market in banking. Any credit institution authorized in a Member State of the EEC will be able to establish branches and to offer its services freely throughout the Community to individuals and businesses.[23] The harmonization of the banking sector is part of the general attempt to complete the creation of the internal European market.[24] The approach of the Second Directive is based on the policy decisions endorsed in a White Paper from the Commission to the European Council entitled "Completing the Internal Market" (the "White Pa-

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17. *See* Explanatory Memorandum, *supra* note 16, at I.3.

18. Proposal for a Council Directive on the Own Funds of Credit Institutions COM(86) 169 final 2, O.J. C 243/4 (1986). "Own funds" is defined as "the credit institution's own capital, including items which may be treated as capital under national rules." First Directive, *supra* note 5, art. 1, at 31; Second Directive, *supra* note 1, art. 1, at 3; *see infra* notes 97-100 and accompanying text.

19. Commission Recommendation of 22 December 1986 on Monitoring and Controlling Large Exposures of Credit Institutions (87/62/EEC), O.J. L 33/10 (1987).

20. Proposal for a Council Directive on a Solvency Ratio for Credit Institutions COM(88) 194 final, O.J. C 135/4 (1988).

21. Commission Recommendation of 22 December 1986 Concerning the Introduction of Deposit-Guarantee Schemes in the Community (87/63/EEC), O.J. L 33/16 (1987).

22. *See* Explanatory Memorandum, *supra* note 16, at I.1; *see also* Second Directive, *supra* note 1, first whereas clause, at 1.

23. *See* Second Directive, *supra* note 1, tenth whereas clause, at 2.

24. *See* Completing the Internal Market: White Paper from the Commission to the European Council, COM(85) 310 final (June 14, 1985) [hereinafter White Paper].

per").[25] In accordance with the White Paper, the Second Directive does not create a uniform body of banking law for the EEC. However, it obligates each Member State to mutually recognize the laws of and licenses from other Member States. These laws and licenses will remain different from Member State to Member State, while only a few essential supervisory standards will be harmonized in the banking laws of the Member States.[26] The White Paper suggests that such harmonization, as far as it concerns the supervision of ongoing activities of credit institutions, should be guided by the principle of "home country control," according to which the primary task of supervising a credit institution should be attributed to the competent authorities of the institution's Member State of origin.[27]

Authorization for the establishment or the acquisition of a credit institution subsidiary by a non-EEC person in the EEC is subject to a finding by the Commission that EEC credit institutions enjoy reciprocal treatment, in particular, regarding the establishment of a subsidiary or the acquisition of a participation in a credit institution, in the non-EEC country in question.[28]

The Second Directive is addressed to the Member States. They must conform their laws to the Second Directive at the latest by January 1, 1993.[29]

III. *THE SINGLE BANKING LICENSE: FREEDOM OF ESTABLISHMENT AND FREEDOM TO PROVIDE SERVICES*

A. *Mutual Recognition of Banking Licenses*

The Second Directive will permit any credit institution[30]

25. *Id.* ¶¶ 101-107.
26. *Id.* ¶¶ 102-103.
27. *Id.* ¶ 103.
28. Second Directive, *supra* note 1, art. 7(5), at 4; *see infra* notes 122-31 and accompanying text.
29. Second Directive, *supra* note 1, art. 22(1), at 9.
30. "Credit institution" is defined in article 1 of the First Directive as "an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account." First Directive, *supra* note 5, art. 1, at 31. The definition of the First Directive is incorporated into the Second Directive. *See* Second Directive, *supra* note 1, art. 1, at 3; *see also infra* notes 74-82 and accompanying text. Article 2(2) of the First Directive, as amended by Council Directive of 27 Octo-

authorized[31] in a Member State (the "Home Member State")[32] (i) to establish branches in other Member States[33] and (ii) to offer its services freely throughout the Community to individuals and businesses.[34] This is the centerpiece of the Second Directive.

EEC credit institutions will be entitled to operate under their Home Member State license, which will be a "single banking license" throughout the Community.[35] The Home Member State license will permit a credit institution to supply certain banking services, which are enumerated in the Second Directive, in other Member States (the "Host Member State")[36] either by acting itself across the border or through a *branch* (but not through a *subsidiary* credit institution),[37] which it

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ber 1986 amending Directive 77/780/EEC in Respect of the List of Permanent Exclusions of Certain Credit Institutions (86/524/EEC), O.J. L 309/15 (1986) [hereinafter Amending Directive], excludes, *inter alia*, the following institutions from the scope of the First Directive and Second Directive: central banks of Member States, post office giro institutions, and individually specified institutions of the different Member States, that serve (semi-) official purposes. *Id.* at 15-16.

31. "Authorization" is defined in article 1 of the First Directive as "an instrument issued in any form by the authorities by which the right to carry on the business of a credit institution is granted." First Directive, *supra* note 5, art. 1, at 31. The definition of authorization in the First Directive is incorporated into the Second Directive, *supra* note 1, art. 1, at 3.

32. See the definition of "home Member State" in the Second Directive, *supra* note 1, art. 1, at 3.

33. *Id.* art. 5(1), at 3. "Branch" is defined in article 1 of the First Directive as

> a place of business which forms a legally dependent part of a credit institution and which conducts directly all or some of the operations inherent in the business of credit institutions; any number of branches set up in the same Member State by a credit institution having its head office in another Member State shall be regarded as a single branch . . . .

First Directive, *supra* note 1, art. 1, at 31. The definition of branch in the First Directive is incorporated into the Second Directive, *supra* note 1, art. 1, at 3.

34. Second Directive, *supra* note 1, art. 16(1), at 7.

35. *Id.* second whereas clause, at 1; *see id.* art. 5(1), at 3.

36. "Host Member State" is defined in article 1 of the Second Directive as "the Member State where a credit institution has a branch or into which it supplies services." Second Directive, *supra* note 1, art. 1, at 3.

37. In contrast to a branch, a subsidiary institution is an entity legally independent from the parent credit institution. "Subsidiary" is defined in article 1 of the Second Directive by reference to article 1 of the Seventh Council Directive, O.J. L 193/1, at 2 (1983), as an undertaking in which a parent undertaking has a majority of the shareholders' or members' voting rights, or has the right to appoint or remove a majority of the administrative, management, or supervisory body and is at the same time a shareholder, or which can be controlled by the parent undertaking by means of other arrangements or rights. Second Directive, *supra* note 1, art. 1, at 3.

may establish anywhere in the EEC, without any further authorization by the Host Member State.[38] Thus, the Second Directive does not create a European "federal" banking license; it decrees that each Member State's banking license shall be valid throughout the EEC. The principle proposed by the Second Directive is one of "mutual recognition": each Member State recognizes the banking license of the other Member States. This principle differs radically from the concept of "national treatment"[39] prevailing in the United States. "National treatment" means that a foreign bank is entitled to the same treatment as a domestic bank and that it will not be subject to discrimination. The principle of mutual recognition gives credit institutions licensed in one Member State access to all Member States.[40] This EEC-wide access creates an inter-Member State banking market, which differs from the single-state U.S. banking market.[41]

The recognition of the Home Member State license required by the Second Directive is limited to certain specified banking activities: the Home Member State license is valid in other Member States only with respect to those specified banking activities that are enumerated in the annex to the Second Directive (the "Annex").[42] The Annex defines the scope of the principle of mutual recognition. Each Member State will have the duty to ensure that at least the activities listed in the Annex may be pursued in its territory by any credit institution authorized and supervised by the competent authorities of its Home Member State, either through the establishment of a branch or by way of provision of services across the Member State bor-

38. *Id.* art. 5(1), at 3.

39. The International Banking Act of 1978, 12 U.S.C. § 3101 (1982), incorporates the principle of national treatment as a basis for the rules governing the entry and subsequent operations of foreign banks. *See* Board of Governors of the Fed. Reserve Sys., Policy Statement on Supervision and Regulation of Foreign-Based Bank Holding Companies, 1 Fed. Res. Reg. Serv. 4-835 (Apr. 1983); Gruson & Jackson, *Issuance of Securities by Foreign Banks and the Investment Company Act of 1940*, 1980 U. ILL. L.F. 185, 198 n.82; Orr, *Reciprocity and Regulation of Entry*, 1988 U. ILL. L. REV. 333; *see also* Conference of State Bank Supervisors v. Conover, 715 F.2d 604, 617 (D.C. Cir. 1983), *cert. denied*, 466 U.S. 927 (1984).

40. Second Directive, *supra* note 1, arts. 5(1), 16(1), at 3, 7.

41. *See infra* notes 149-61 and accompanying text.

42. Second Directive, *supra* note 1, art. 16(1), at 7; *see infra* notes 48-53 and accompanying text.

der.[43]

The authorization by its Home Member State will permit a credit institution to provide services throughout the Community with respect to banking activities that meet the following cumulative criteria: (1) the Home Member State license must permit the pursuit of such activity, and (2) the activity must be set out in the Annex.[44]

As a consequence, any credit institution authorized as such in its Home Member State may exercise activities that meet such criteria in the Host Member State even if the same activities are not permitted to similar credit institutions of the Host Member State. For instance, if a bank is authorized by its Home Member State license to engage in financial leasing transactions, it is permitted to do so anywhere in the EEC, since financial leasing is an activity listed in the Annex. On the other hand, if the Home Member State license does not authorize financial leasing, a credit institution may not engage in this activity in a Host Member State even if credit institutions licensed in the Host Member State are entitled to engage in this activity. If the Home Member State license permits travel agency services, a credit institution still cannot conduct this activity in a Host Member State by virtue of the Second Directive, because travel agency services are not set forth in the Annex.

Any credit institution wishing for the first time to exercise the freedom to supply services in the territory of another Member State must notify the competent authorities[45] of the Home Member State of the activities included in the Annex that it intends to undertake.[46] Such notice will simply be forwarded to the competent authorities of the Host Member State.[47]

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43. Second Directive, *supra* note 1, arts. 5(1), 16(1), at 3, 7.

44. Second Directive, *supra* note 1, art. 16(1), at 7; *see infra* notes 48-53 and accompanying text.

45. "Competent authorities" is defined in article 1 of the Second Directive by reference to Council Directive of 13 June 1983 on the Supervision of Credit Institutions on a Consolidated Basis (83/850/EEC), O.J. L 193/18, at 19 (1983) [hereinafter Directive on Consolidated Supervision], as the national authorities which are empowered by law or regulation to supervise credit institutions. Second Directive, *supra* note 1, art. 1, at 3.

46. *Id.* art. 18(1), at 8.

47. *Id.* art. 18(2), at 8.

B. *The Agreed List of "Banking Activities"*

The core of the proposed Second Directive is the single banking license and, associated with it, the agreed list of "banking activities" in the Annex for which the single license is valid.[48]

The list in the Annex sets forth the following banking activities, which are "integral to banking" and for which, therefore, the single banking license is valid:

1. Deposit-taking and other forms of borrowing
2. Lending [including in particular: consumer credit, mortgage lending, factoring and invoice discounting, and trade finance (including forfeiting)]
3. Financial leasing
4. Money transmission services
5. Issuing and administering means of payment (credit cards, travellers cheques and bankers drafts)
6. Guarantees and commitments
7. Trading for own account or for account of the customers in:
   (a) money market instruments (cheques, bills, CDs, etc.)
   (b) foreign exchange
   (c) financial futures and options
   (d) exchange and interest rate instruments
   (e) securities
8. Participation in securities issues and the provision of services related to such issues
9. Money broking
10. Portfolio management and advice
11. Safekeeping of securities
12. Credit reference services
13. Safe custody services.[49]

The Annex encompasses all of the activities that currently, in the opinion of the Commission, constitute the core of the traditional banking services in the EEC.[50] This list has been drawn up on a liberal "universal banking" model.[51] From the point of view of U.S. banks, the most important aspect of the

48. *See id.* art. 16, at 7.
49. *Id.* annex, at 10 (footnote omitted).
50. Explanatory Memorandum, *supra* note 16, at II.4(a).
51. The Annex does not distinguish between investment banking and commer-

Annex is the inclusion of a broad range of transactions in securities, specifically:

—trading for its own account or for account of customers in all types of securities (whether corporate stocks or short and long-term debt);

—participation in securities issues (underwriting) and the provision of services related to such issues; and

—portfolio management and advice.[52]

The Commission recommends that the Annex be updated under a flexible procedure so that it can respond to the development of new banking services.[53]

It is, of course, possible that the banking license of a Member State permits banking activities beyond the scope of the Annex. In that case, the Host Member State is not required to permit such activities.

C. *Failure to Harmonize the Banking Powers in the Different Member States*

The Second Directive does not intend to harmonize the scope of the banking licenses issued by the various Member States (i.e., the powers of their banks), but leaves it to the Home Member State to decide what banking activities a credit institution is permitted to pursue under the banking license it will issue.[54] It will be possible that the banking powers permitted by the banking license of a Member State will fall short of those powers set forth in the Annex. In that case, credit institutions from other Member States may provide services in a Host Member State that credit institutions licensed by that Host Member State are not permitted to provide. One might expect that Member States that do not grant their credit institutions all the powers set forth in the Annex will be exposed to pressure from their banking industry to expand the permitted banking powers to the fullest extent allowed by the Annex in

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cial banking. Thus, it does not embrace the philosophy of the Glass-Steagall Act. *See infra* notes 144-46 and accompanying text.

52. Second Directive, *supra* note 1, annex, at 10.

53. *See* Explanatory Memorandum, *supra* note 16, at II.4(a); *see also* Second Directive, *supra* note 1, art. 20(1), at 9. The Commission apparently wishes to avoid repeating the experience of U.S. banking law, which does not easily respond to changing market environments.

54. Second Directive, *supra* note 1, art. 16, at 7.

order to permit competitive equality. It can be expected that all banking licenses of Member States will eventually cover all of the banking powers set forth in the Annex.[55]

A non-EEC credit institution that wishes to establish a subsidiary credit institution in a Member State in order to benefit from the principle of mutual recognition would be well advised to set up the subsidiary in a Member State that grants a banking license permitting all (or most) of the activities listed in the Annex. As soon as the Second Directive is implemented, such a credit institution would enjoy a competitive advantage in the whole Community over credit institutions from more restrictive Member States.

The Commission seems to assume that the remaining legal differences among Member States (including taxation) affecting the business environment of credit institutions will eventually erode. EEC-wide competition will punish Member States with undue restrictions, because they will lose banking business to other more liberal Member States. The idea is that competition, and not interference, will gradually create a unified market.[56]

D. *Establishment of Branches in a Host Member State*

Under the Second Directive, the Host Member State will no longer require any authorization for the establishment of branches of credit institutions that are authorized in other Member States.[57] The Second Directive provides a procedure for cooperation between Home Member State and Host Member State authorities relating to the establishment of branches.[58] A credit institution wishing to establish a branch in another Member State must notify the authorities of its Home Member State[59] and provide certain specified information (for example, program of operations, amount of own funds and solvency ratio of the credit institution, address and names of managers).[60] The Home Member State must communicate the information to the Host Member State within

55. This is commonly referred to as "the race for the bottom."
56. *See Superbank. A Survey*, ECONOMIST, Mar. 26, 1988, at 69.
57. Second Directive, *supra* note 1, art. 5(1), at 3.
58. *Id.* art. 17, at 7-8.
59. *Id.* art. 17(1), at 7; *see* Explanatory Memorandum, *supra* note 16, at II.4(c)1.
60. Second Directive, *supra* note 1, art. 17(2), at 7.

three months.[61] However, if after examining the notification the competent authority of the Home Member State has reason to doubt the adequacy of the organizational structure of the credit institution, taking into account the envisioned operations, the Home Member State may refuse to send the information to the prospective Host Member State authorities, but only upon giving reasons therefor.[62] This refusal is subject to a right of appeal to the courts in the Home Member State.[63]

E. *The Abolition of Initial Endowment Capital*

The Second Directive abolishes the initial endowment capital that is currently required by the majority of Member States for the authorization of branches of credit institutions already authorized in other Member States.[64] Such Member States treat branches as if they were separate institutions. The requirement of endowment capital is a barrier against the freedom of establishment of branches.

The Second Directive provides for a transitional rule, which applies from January 1, 1990, until all requirements for Host Member State authorization of branches of credit institutions authorized in other Member States have been abolished. During that period, the Host Member States may *not* require, as a condition for authorization of a branch of an EEC credit institution authorized in another Member State, an initial endowment capital in excess of fifty percent of the minimum capital required by the Host Member State for authorization of credit institutions of the same nature.[65]

IV. *HOME COUNTRY AND HOST COUNTRY SUPERVISION*

The guiding principle on which the Second Directive is based is that of home country control:[66] a credit institution

61. *Id.* art. 17(3), at 7.

62. *Id.*

63. *Id.*

64. Second Directive, *supra* note 1, art. 5(2), at 3-4; Explanatory Memorandum, *supra* note 16, at II.2(c).

65. Second Directive, *supra* note 1, art. 5(2), at 3-4. The rule does not benefit branches of non-EEC banks. Member States shall adopt the measures necessary to comply with the provision of article 5(2) of the Second Directive by January 1, 1990. *Id.* art. 22(2), at 9.

66. *See id.* seventh whereas clause, at 1; Explanatory Memorandum, *supra* note 16, at I.2; White Paper, *supra* note 24, ¶ 103.

will be supervised, even with regard to activities it provides on a cross-border basis or through a branch in another Member State, principally by the authorities of its Home Member State.[67]

As a result of insufficient harmonization of liquidity standards and of insufficient coordination in the implementation of monetary policy in the EEC, the Second Directive proposes that, as an exception to the principle of home country control, the Host Member State, pending further coordination, will retain primary responsibility for the supervision of liquidity of credit institutions and exclusive responsibility for the implementation of monetary policy.[68] These measures, however, must not embody discriminatory or restrictive treatment based on the fact that a credit institution is authorized in another Member State.[69]

The Second Directive also provides that until further coordination, the authorities of the Host Member State in cooperation with the authorities of the Home Member State may take the necessary measures to require credit institutions to make sufficient provisions against the *market risk* incurred by such institutions by virtue of operations in the securities markets in the Host Member State.[70] In the opinion of the Commission, this arrangement is necessary in the light of the events of October 1987, and particularly because the proposal for a directive on solvency ratios[71] will cover only *credit risk* (i.e., risk attaching to the particular type of counterparty in receipt of,

67. Second Directive, *supra* note 1, art. 19(1), at 8; *see* White Paper, *supra* note 24, at 28, ¶ 103; *see also* Second Directive, *supra* note 1, art. 11, at 5.

68. Second Directive, *supra* note 1, art. 12(2), at 5.

69. *Id.*

70. *Id.* art. 12(3), at 5. For a discussion of the systematic or market risk, see Macey & Miller, *Bank Failures, Risk Monitoring, and the Market for Bank Control*, 88 COLUM. L. REV. 1153, 1171 (1988). U.S. commercial banks are not allowed to deal in securities, thus U.S. banking law does not have comparable prudential standards with respect to the market risk of securities. Examination and supervisory procedures have been established to assure that international exchange risk is considered in evaluating the capital adequacy of banking institutions. 12 U.S.C. § 3903 (Supp. IV 1986). Provisions protecting against market risk are in the margin requirements for broker/dealers, Regulation T under the Securities Exchange Act of 1934, 12 C.F.R. pt. 220 (1988), and in the credit restrictions imposed upon banks that extend credit for the purpose of buying or carrying margin stock if the credit is secured by margin stock, Regulation U under the Securities Exchange Act of 1934, 12 C.F.R. pt. 221 (1988).

71. *See supra* note 20.

for example, a bank loan or guarantee).[72] Securities transactions (and most underwriting and dealing), however, involve market or position risk (i.e., the risk of a general fall in the market to which anyone who has taken an open position is exposed), which is not intended to be covered by the solvency ratio directive.[73]

V. *WHAT IS A "CREDIT INSTITUTION" BENEFITING FROM THE SECOND DIRECTIVE*

A. *Credit Institutions*

A "credit institution" is defined as an "undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account . . . ."[74] According to the Second Directive, credit institutions that are authorized and supervised as credit institutions by the competent authorities of their Home Member States will benefit from mutual, i.e., EEC-wide, recognition of their banking licenses with respect to the activities enumerated in the Annex and for which they are licensed in the Home Member State.[75] This means that the following entities do not benefit from mutual recognition:

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72. Explanatory Memorandum, *supra* note 16, at II.3(c).

73. *Id.*; *see* Second Directive, *supra* note 1, art. 12(3), at 5. The proposed solvency ratio directive, *see supra* note 20, relates the credit institution's own funds (i.e., capital, which is the numerator of the ratio) to its total assets and off-balance sheet liabilities (the denominator of the ratio). It establishes a uniform method of assessing the ability of a credit institution to meet losses arising from the default of their customers on the basis of risk weights for the components of the denominator. *See* the Risk-Based Capital Guidelines for Banks and Bank Holding Companies, 54 Fed. Reg. 4177 (1989) (to be codified at 12 C.F.R. pt. 3, app. A) (national banks), 54 Fed. Reg. 4197 (1989) (to be codified at 12 C.F.R. pt. 208, app. A (Regulation H)) (state member banks), 54 Fed. Reg. 4209 (1989) (to be codified at 12 C.F.R. pt. 225, app. A (Regulation Y))(bank holding companies).

74. First Directive, *supra* note 5, art. 1, at 31. The Bank Holding Company Act of 1956 (the "BHCA") defines "bank" in a similar fashion: "[a]n institution organized under the laws of the United States . . . which both—(i) accepts demand deposits or deposits that the depositor may withdraw by check or similar means for payment to third parties or others; and (ii) is engaged in the business of making commercial loans." BHCA, § 2(c), 12 U.S.C § 1841(c) (1982), as amended by the Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, § 101(a)(1), 1987 U.S. CODE CONG. & ADMIN. NEWS (101 Stat.) 552, 554-57. See the exclusions in article 2(2) of the First Directive, *supra* note 5, at 31-32, as amended by the Amending Directive, *supra* note 30, at 15-16.

75. Second Directive, *supra* note 1, arts. 5(1), 16(1), at 3, 7.

(i) entities that are not authorized and supervised as credit institutions by a Member State, even though they are engaged in some of the activities set forth in the Annex (for example, if a company engages only in financial leasing and as such is not regulated by the Home Member State as a credit institution, it is not a credit institution under the Second Directive, although financial leasing is an activity listed in the Annex);[76]

(ii) entities that do not engage in any of the activities included in the Annex even though they are authorized and supervised as credit institutions by a Member State.

An entity that has not been granted an authorization as a *credit institution* by its Home Member State does not benefit from mutual recognition under the Second Directive.[77] Such an entity can operate in a Host Member State only by virtue of the general rules of the Treaty of Rome concerning the right of establishment[78] and the free provision of services.[79] If the activities of such an entity are subject to authorization in the Host Member State, such authorization must be obtained. A Host Member State cannot refuse to grant an authorization where this would constitute discrimination based solely on nationality.[80]

Branches in EEC countries of non-EEC credit institutions do not benefit from the principle of mutual recognition, since such non-EEC credit institution branches are not "credit institutions authorized in other Member States."[81] On the other hand, subsidiaries established in EEC countries by non-EEC persons under a license for credit institutions are "credit institutions" benefiting from the principle of mutual recognition. In other words, non-EEC ownership or control of a credit institution does not destroy the mutual recognition of the license

76. This is true even if the activity can be undertaken in the Home Member State without prior authorization. Articles 5(1) and 16(1) of the Second Directive apply only to "credit institutions." *Id.* arts. 5(1), 16(1), at 3, 7.

77. *See id.* arts. 2, 5(1), at 3. This is true even if the activity that the entity exercises is included in the Annex and can be undertaken in the Home Member State without any prior authorization.

78. Treaty of Rome, *supra* note 2, arts. 52-58, 1973 Gr. Brit. T.S. No. 1, at 23-25, 298 U.N.T.S. at 37-40.

79. *Id.* arts. 59-66, 1973 Gr. Brit. T.S. No. 1, at 25-27, 298 U.N.T.S. at 40-42.

80. *Id.* art. 52, 1973 Gr. Brit. T.S. No. 1, at 23, 298 U.N.T.S. at 37.

81. Second Directive, *supra* note 1, art. 5(1), at 3; *see id.* art. 16(1), at 7.

of the credit institution. Credit institution subsidiaries of non-EEC banks that are already authorized to do business in a Member State before the entry into force of the Second Directive would benefit from the rules of the Second Directive and would not be subject to the new reciprocity requirements of the Second Directive applicable to non-EEC entities establishing a credit institution in a Member State.[82]

B. *Non-Credit Institution Subsidiaries of Credit Institutions*

In some Member States credit institutions are not authorized to engage directly in some of the activities listed in the Annex (for example, leasing, factoring, dealing in securities, mortgage lending) but must conduct such activities through subsidiaries.[83] These subsidiaries do not qualify as credit institutions according to the First Directive[84] and, as a result, they would not benefit from mutual recognition under the Second Directive. The Second Directive, however, permits such credit institution subsidiaries to branch freely and to provide services in the Member States, provided the following conditions are met:[85]

(i) the activities of the subsidiary are fully consolidated with those of the parent credit institution;[86]

(ii) the parent is a credit institution authorized in the Member State whose law governs the subsidiary and holds ninety percent or more of the shares of the subsidiary;[87]

(iii) the parent credit institution accepts full responsibility

82. *See infra* notes 122-31 and accompanying text.

83. *See* Explanatory Memorandum, *supra* note 16, at II.4(b).

84. For a definition of credit institutions, see *supra* note 30.

85. Second Directive, *supra* note 1, art. 16(2), at 7. Subsidiaries of an EEC credit institution meeting the conditions of article 16 of the Second Directive are called "financial institutions conforming to the conditions laid down in Article 16(2)." *Id.*

86. *Id.* Article 16(2) of the Second Directive in accordance with the Directive on Consolidated Supervision, *supra* note 45, requires that the subsidiary is effectively included, in particular for the activities in question, in the consolidated supervision of its parent credit institution notably for the calculation of the solvency ratio, for the control of large exposures, and for the purposes of limiting participations in accordance with article 10 of the Second Directive. Second Directive, *supra* note 1, art. 16(2), at 7.

87. Second Directive, *supra* note 1, art. 16(2), at 7. Holding companies controlling the credit institution and the subsidiary would not be permissible. Article 16(2) of the Second Directive permits the joint ownership of a subsidiary by several EEC credit institutions. *Id.*

for the subsidiary, i.e., it must guarantee the commitments entered into by the subsidiary.[88]

The principle of Home Member State control and supervision applies to such subsidiaries.[89] The extension of the rule of mutual recognition to subsidiaries applies only to subsidiaries of a credit institution authorized in a Member State. It does not apply to U.S.-based or EEC-based non-bank subsidiaries of a U.S. bank or a U.S. bank holding company. Such EEC-based subsidiaries of a U.S. bank or bank holding company must be authorized as credit institutions in a Member State in order to benefit from the Second Directive.

VI. *HARMONIZATION OF ESSENTIAL SUPERVISORY STANDARDS*

Although the Second Directive does not provide for a uniform banking license for all Member States, the Commission is of the view that the concept of home country control requires a harmonization of essential supervisory standards.[90] The standards to be harmonized in the Second Directive are

(1) minimum capital for authorization[91] and continuing business;[92]

(2) supervisory control of major shareholders[93] and of banks' participations in the non-bank sector;[94] and

(3) sound accounting and control mechanisms.[95]

The provisions for mutual recognition and home country control in articles 16 through 19 will take effect at a date prior to the ultimate deadline of January 1, 1993, only if Member State legislation is in place on own funds and on harmonized

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88. *Compare id. with* §§ 23A & 23B of the Federal Reserve Act, 12 U.S.C. § 371(c) (1982), as amended by the Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, § 102(a), 1987 U.S. CODE CONG. & ADMIN. NEWS (101 Stat.) 552, 564-65, which severely restrict all transactions (including guarantees) by member banks and their affiliates. Section 23A applies to FDIC insured banks by virtue of § 18(j) of the Federal Deposit Insurance Act, 12 U.S.C. § 1828(j) (1982), *amended by* Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, §§ 102(b), 103(a), 1987 U.S. CODE CONG. & ADMIN. NEWS (101 Stat.) 552, 566-67.

89. Second Directive, *supra* note 1, art. 16(2), at 7.

90. Explanatory Memorandum, *supra* note 16, at I.6.

91. Second Directive, *supra* note 1, arts. 3, 8, at 3, 4.

92. *Id.* art. 8, at 4.

93. *Id.* art. 9, at 4-5.

94. *Id.* art. 10, at 5.

95. *Id.* art. 11, at 5.

solvency ratios.[96]

A. *Minimum Capital for Authorization and Continuing Business*

The First Directive stipulates that a credit institution should possess "adequate minimum own funds" when starting its business.[97] The Second Directive introduces the requirement that a credit institution may only be authorized if it has an initial capital of at least five million ECU.[98] Each Member State is free, however, to apply higher levels for its own credit institutions.[99] In addition, the Second Directive endorses the principle of prudential supervision, by stipulating that a credit institution's own funds must not fall below the initial capital required for its authorization.[100]

B. *Control of Major Shareholders*

As in the United States, the ownership and control of a credit institution by non-banking interests is an issue of concern for the Community because of the risks of cross-financing and conflicts of interest. For this reason the Second Directive stipulates that the supervisory authorities of the Home Member State, before granting an authorization to a credit institution, must be informed of the identity of shareholders and members holding a qualified participation in the proposed credit institution as well as of the amount of such participations.[101] For purposes of the Second Directive, a "qualified participation" is defined as "a holding, direct or indirect, in an undertaking which represents 10% or more of the capital or of the voting rights or which enables the exercise of a significant

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96. *Id.* art. 22, at 9; *see* Explanatory Memorandum, *supra* note 16, at I.6.

97. First Directive, *supra* note 5, art. 3(2), at 33. "Own funds" is defined in article 1 of the First Directive as "the credit institution's own capital, including items which may be treated as capital under national rules." *Id.* at 31; *see supra* note 18.

98. Second Directive, *supra* note 1, art. 3, at 3.

99. Explanatory Memorandum, *supra* note 16, at II.2(a). In the United States, an extensive web of statutory and regulatory provisions is intended to ensure safety and soundness of banks, for instance, by imposing capital adequacy standards, prudential standards, lending limits, restrictions on loans to affiliates, restraints on the issue of guarantees, and restraints on leasing activities.

100. Second Directive, *supra* note 1, art. 8(1), at 4; *see* Explanatory Memorandum, *supra* note 16, at II.3.

101. Second Directive, *supra* note 1, art. 4, at 3.

influence . . . ."[102] This provision applies to direct or indirect shareholders and members.[103] The competent authorities are directed to "appraise the suitability" of the shareholders and members[104] and possibly to reject any particular shareholder structure as improper when the institution is being formed.[105]

The Second Directive also requires prior notification to the competent authorities of the Member State of a proposed direct or indirect acquisition of a qualified participation in a credit institution that is already in operation[106] and of a proposed increase of a qualified participation that would result in the credit institution becoming a subsidiary.[107] This provision enables the supervisory authorities to assess, and as they see fit to reject, any inappropriate group structure that could be detrimental to safe and sound banking management.[108] The notification obligation is imposed first upon the prospective shareholders or members who are considering the acquisition, directly or indirectly, of, or an increase in, a qualified participation in a credit institution.[109] In addition, the credit institution itself must each year furnish to the competent authorities of its Home Member State the names of major shareholders and members and the size of their qualified participations.[110]

Whenever shareholders or members holding qualified

102. *Id.* art. 1, at 3. The term "significant influence" is defined in article 33 of the Seventh Council Directive of 13 June 1983 based on the Article 54(3)(g) of the Treaty on Consolidated Accounts (83/349/EEC), O.J. L 193/1, at 10 (1983) [hereinafter Seventh Council Directive] as presumed to be existing when an undertaking "has 20% or more of the shareholders' or members' voting rights in [another] undertaking."

103. Second Directive, *supra* note 1, art. 4, at 3. Article 4 applies to physical and legal persons who are shareholders or members. *Id.*

104. *Id.*

105. Explanatory Memorandum, *supra* note 16, at II.2(b).

106. Second Directive, *supra* note 1, art. 9(1), at 4.

107. *Id.* "Subsidiary" is defined in article 1 of the Second Directive by reference to article 1 of the Seventh Council Directive, *supra* note 102, at 2, as an undertaking in which a parent undertaking has a majority of the shareholders' or members' voting rights, or has the right to appoint or remove a majority of the administrative, management, or supervisory body and is at the same time a shareholder, or that can be controlled by the parent undertaking by means of other arrangements or rights. Second Directive, *supra* note 1, art. 1, at 3.

108. Explanatory Memorandum, *supra* note 16, at II.3(a).

109. Second Directive, *supra* note 1, art. 9(1), at 4.

110. *Id.* art. 9(2), at 4.

participations in a credit institution exercise their influence in a way that is likely to be detrimental to prudent and sound management of the banking activities of the credit institution, the competent authorities of the Member State may take "appropriate measures to bring such a situation to an end."[111] Such measures may consist, in particular, of injunctions, sanctions against directors and managers, or the suspension of the voting rights of the shares held by the shareholders or members in question.[112] The Second Directive does not specify under what conditions a Member State may take such serious measures.

C. *Non-Financial Subsidiaries*

The participations of credit institutions in other credit or financial institutions is governed by the Directive on Consolidated Supervision.[113] The Second Directive contains, however, provisions on the participation by credit institutions in *non*-credit and *non*-financial institutions.[114] These investments require particular attention, because they may affect the financial stability of the investing credit institution.[115] Participations in a subsidiary may affect the soundness of the credit institution if the former runs into financial difficulties (contagion risk) and equity participations constitute a long-term freezing of the assets of the investing credit institution.[116]

The Second Directive harmonizes differing standards of the Member States regarding equity participation of credit in-

111. *Id.* art. 9(3), at 4-5.

112. *Id.*

113. Directive on Consolidated Supervision, *supra* note 86. The Directive on Consolidated Supervision provides that if more than 25% of the capital of a credit institution or financial institution is owned by another credit institution, it will be supervised on a consolidated basis by the competent authorities of the Home Member State of the parent credit institution. *Id.* arts. 1, 3(3), at 19. "Financial institution" is defined in article 1 of the Directive on Consolidated Supervision as "an undertaking, not being a credit institution, whose principal activity is to grant credit facilities (including guarantees), to acquire participations or to make investments." *Id.* art. 1, at 19. This definition applies to the Second Directive by virtue of article 1 of the Second Directive. Second Directive, *supra* note 1, art. 1, at 3. Although it is not entirely clear from this definition what kind of activities are encompassed, the term is broader than the term "bank" as defined in § 2(c) of the BHCA. *See supra* note 74; *see also infra* note 117.

114. Second Directive, *supra* note 1, art. 10, at 5.

115. Explanatory Memorandum, *supra* note 16, at II.3(b).

116. *Id.*

stitutions by limiting credit institutions in the following two respects: if they wish to acquire or maintain participations in non-credit or non-financial institutions,

(i) a credit institution may not hold a qualified (ten percent or more) participation of an amount greater than ten percent of its *own funds* (i.e., its capital) in a company that is neither a credit institution nor a financial institution;[117] and (ii) the total value of such qualified participations may not exceed fifty percent of own funds (i.e., the capital) of the credit institution.[118]

These limits do not apply in the case of shares held (i) temporarily during a financial rescue or restructuring operation, (ii) during the normal course of the underwriting process, or (iii) in the institution's own name but on behalf of others.[119] If the limits are exceeded, in exceptional circumstances the supervisory authorities of the Home Member State must require the credit institution either to increase its capital or to take other remedial measures.[120] The authorities of the Home Member State need not apply these limits if they require that

117. Second Directive, *supra* note 1, art. 10(1), at 5. For the definition of "qualified participation," see *supra* note 102 and accompanying text. "Financial institution" is defined in article 1 of the Directive on Consolidation Supervision as "an undertaking, not being a credit institution, whose principal activity is to grant credit facilities (including guarantees) to acquire participations or to make investments." Directive on Consolidation Supervision, *supra* note 86, art. 1, at 19; *see supra* note 113. The limits do not apply to qualified participation in undertakings the activities of which are a direct extension of banking or concern services ancillary to banking, such as leasing, factoring, the management of unit trusts, the management of data processing services, or any other similar activity. *Compare* article 43(2)(f) of the Council Directive of 8 December 1986 on the Annual Accounts and Consolidated Accounts of Banks and Other Financial Institutions, O.J. L 372/1 (1986), applicable by virtue of article 10(1) of the Second Directive, *supra* note 1, at 5 *with* BHCA, § 4(c)(6), 12 U.S.C. § 1843(c)(6) (1982), pursuant to which U.S. bank holding companies may not control more than five percent of any class of voting stock of a company engaged in non-banking activities *and* BHCA, § 4(c)(8), 12 U.S.C. § 1843(c)(8) (1982), *amended by* Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, § 502(h)(2), 1987 U.S. CODE CONG. & ADMIN. NEWS (101 Stat.) 552, 628-29, pursuant to which U.S. bank holding companies may own 100% of subsidiaries engaged in activities closely related to banking.

118. Second Directive, *supra* note 1, art. 10(2), at 5. For the definition of "financial institution" see *supra* note 117.

119. Second Directive, *supra* note 1, art. 10(3), at 5. This provision can be compared with the exception for the acquisition of shares for "a debt previously contracted" under § 4(c)(2) of the BHCA, 12 U.S.C. § 1843(c)(2) (1982). For the comparable underwriting exception, see Regulation Y, 12 C.F.R. § 225.124(d) (1988).

120. Second Directive, *supra* note 1, art. 10(4), at 5.

the qualified participations in question be deducted when calculating the capital of the relevant credit institutions.[121]

VII. *IMPACT ON NON-EEC CREDIT INSTITUTIONS: RECIPROCITY*

Subsidiaries of non-EEC entities established in any Member State that are authorized as credit institutions by such Member State may benefit in the same way as other EEC credit institutions from mutual recognition of their license, i.e., they have the right to establish branches and to provide services throughout the EEC.[122] Thus, a non-EEC entity can only benefit from the principles of the Second Directive if it has a credit institution subsidiary authorized in a Member State,[123] while branches of non-EEC banks in the EEC do not have the benefit of these rights.[124] As discussed above, the First Directive contains certain provisions applicable to the authorization of branches of non-EEC banks.[125]

For the establishment of a credit institution subsidiary or the acquisition of a participation in an EEC credit institution by a non-EEC bank, the Second Directive establishes a requirement of reciprocity.[126] This reciprocity is an EEC-wide reciprocity, i.e., credit institutions from all Member States must enjoy reciprocal treatment in the country of the applying non-EEC bank.[127] Reciprocity is enforced by means of an advance consultation procedure with the Commission that is initiated by the Member State in which the non-EEC person desires to establish a subsidiary credit institution or to acquire a participation in a credit institution.[128] The Member State must inform the other Member States and the Commission of such request.[129]

Within three months, the Commission shall examine

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121. *Id.* art. 10(6), at 5.
122. *Id.* arts. 5(1), 16(1), at 3, 7.
123. *See id.*
124. *See supra* note 16 and accompanying text.
125. *Id.* Pursuant to article 9 of the First Directive, authorization of an EEC branch of a foreign bank does not require reciprocal treatment by the foreign country. First Directive, *supra* note 5, art. 9, at 35.
126. Second Directive, *supra* note 1, art. 7, at 4.
127. *Id.* art. 7(5), at 4.
128. *Id.* art. 7(2)-(7), at 4.
129. *Id.* art. 7(2), at 4.

"whether all credit institutions of the Community enjoy reciprocal treatment, in particular regarding the establishment of subsidiaries or the acquisition of participations in credit institutions in the third country in question."[130] If the Commission finds that reciprocity is not ensured in the country of the non-EEC person, it may suspend the decision of the Member State to permit the *de novo* formation or acquisition.[131]

VIII. *THE RECIPROCITY DISCUSSION WITH RESPECT TO THE UNITED STATES*

It is not possible to predict how narrowly or broadly the reciprocity requirement, as it is currently contained in the draft of the Second Directive, will be construed. It is generally recognized that the United States does not discriminate against foreign credit institutions and, indeed, the International Banking Act of 1978 is founded on the principle of "national treatment."[132] U.S. banks are subject to even more stringent limitations than foreign banks with respect to their ability to engage in non-banking activities.[133] If reciprocity means

130. *Id.* art. 7(5), at 4.

131. *Id.* art. 7(6), at 4.

132. *See supra* note 39. There are, however, some discriminatory barriers against foreign banks in the U.S. *See* International Banking Act of 1978, § 4, 12 U.S.C. § 3102(a) (1982) (foreign bank may establish Federal branch or agency in any State only if establishment of branch or agency by foreign bank is not prohibited by State law); U.S. GENERAL ACCOUNTING OFFICE, INTERNATIONAL FINANCE: COMPETITIVE CONCERNS OF FOREIGN FINANCIAL FIRMS IN JAPAN, THE UNITED KINGDOM, AND THE UNITED STATES 21-25 (1988) (discussing exceptions to the rule of national treatment of foreign banks, including among others: the Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, § 3501, 1988 U.S. CODE CONG. & ADMIN. NEWS (102 Stat.) 1107, 1386 (Primary Dealers Act of 1988), restrictions by state insurance regulations on issuance by foreign banks of reinsurance standby letters of credit, and limitations on access to the Fed-wire Overdraft Capacity); U.S. DEP'T COMMERCE, 4 FOREIGN DIRECT INVESTMENT IN THE UNITED STATES app. F-31 (1976) (Foreign Banking in the United States); New York State Bar Ass'n, Int'l Law and Practice Section, Comm. on Int'l Banking, Sec., and Fin. Transactions, *Report on Issuance of Securities by Foreign Banks and Their Finance Subsidiaries Under the Investment Company Act of 1940 and Rule 6c-9* (E.T. Patrikis, Chairman, and E. Gewirtz and M. Gruson, Reporters) to be published in 1989 INT'L L. PRACTICUM __ (treatment of foreign banks as investment companies under the Investment Company Act of 1940); Feinman, *National Treatment of Foreign Banks Operating in the United States: The International Banking Act of 1978*, 11 L. & POL'Y INT'L BUS. 1109 (1979); Glidden & Shockey, *U.S. Branches and Agencies of Foreign Banks: A Comparison of the Federal and State Chartering Options*, 1980 U. ILL. L.F. 65, 73-76.

133. *See* BHCA, § 2(h), 12 U.S.C. § 1841(h) (1982), as amended by the Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, § 205, 1987 U.S. CODE CONG.

"absence of discrimination," reciprocity exists between the United States and the EEC. However, if the EEC intends to apply a kind of "mirror-image" reciprocity requirement,[134] under which a foreign credit institution's access to a country's financial markets is conditioned on that country's own credit institutions receiving privileges in the foreign market identical to those in the home market, then difficult questions arise. The following text analyzes whether the rights granted to EEC credit institutions in the United States are identical to those granted to U.S. credit institutions in the EEC.

A. *Reciprocity with Respect to Establishment and Acquisition*

The Second Directive requires that reciprocal treatment be accorded by the country of a non-EEC person desiring to establish a subsidiary credit institution or to acquire a participation in a credit institution. Such reciprocity shall be accorded by the foreign country "*in particular* regarding the *establishment of subsidiaries* or the *acquisition of participations* in credit institutions . . . ."[135] The United States has a unique dual banking system that leaves foreign banks the choice to obtain a license either under the law of a particular state or under federal law. Since the requirements for establishing and operating banks are different under federal law and under the law of each state, a "mirror-image" reciprocity test would have to look to the jurisdiction in the United States in which the institution seeking authorization in the EEC is chartered. This means that in the case of a state-chartered bank seeking entrance into the EEC, the Commission can only conclude that reciprocal treatment is or is not ensured by the laws of the particular state or, in case of a national bank seeking entrance into the EEC, under federal banking law. The situation is even

& ADMIN. NEWS (101 Stat.) 552, 584-85; International Banking Act of 1978, § 8, 12 U.S.C. § 3106 (1982), *amended by* Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, § 204, 1987 U.S. CODE CONG. & ADMIN. NEWS (101 Stat.) 552, 584; Regulation K, 12 C.F.R. § 211.23(f)(5)(iii) (1988). *See generally* Gruson & Weld, *Nonbanking Activities of Foreign Banks Operating in the United States*, 1980 U. ILL. L.F. 129.

134. *See* Letter from the International Capital Markets Advisory Committee of the Federal Reserve Bank of New York to E. Gerald Corrigan 2 (Nov. 28, 1988) (proposing general principles to be taken into account to ensure fair and open access to financial markets) (available at the *Fordham International Law Journal* office).

135. Second Directive, *supra* note 1, art. 7(5), at 4 (emphasis added).

more complicated because state-chartered banks are also subject to supervision by federal agencies.

Before it is possible to determine whether the United States or any particular state of the United States offers reciprocal treatment in the areas of establishment and acquisition to EEC credit institutions, it is necessary to assess how the EEC treats U.S. credit institutions seeking entry into the EEC banking market. Such treatment differs from Member State to Member State. As stated above, the authorization for the establishment of a credit institution or the acquisition of a credit institution remains in the jurisdiction of the competent authorities of the particular Member State in which the credit institution is or is to be located.[136] The Second Directive neither centralizes nor harmonizes the conditions and requirements for the establishment or acquisition of credit institutions by non-EEC entities.[137] The Second Directive merely decrees that such authorization by the competent authorities of a Member State should be suspended if the Commission finds that reciprocity is not ensured.[138] Since the laws and regulations relating to establishment and acquisition in the different Member States vary, it is not feasible to determine on a "mirror-image" basis whether "all credit institutions of the Community enjoy reciprocal treatment"[139] in the United States with respect to *establishment* and *acquisition*. A comparison of the rights of establishment and acquisition would be possible on a "one-on-one" basis comparing one Member State at a time with the United States or the one state of the United States in which the U.S. credit institution is located. If the law of the United States or the relevant state of the United States must be reciprocal with the laws of *each* Member State, U.S. law must give credit institutions from *all* Member States the same treatment that the Member State with the most "liberal" rules gives to U.S. credit institutions, and the United States must disregard non-reciprocal or discriminatory rules of other Member States. While a "mirror-image" analysis of reciprocity leads to strange results, it is quite possible, however, to determine whether the

136. *See id.* arts. 3, 7, at 3, 4; First Directive, *supra* note 5, art. 3, at 33-34.

137. *Contra* First Directive, *supra* note 5, art. 3, at 33-34, which sets forth certain minimum requirements for the authorization of credit institutions.

138. Second Directive, *supra* note 1, art. 7(6), at 4.

139. *Id.* art. 7(5), at 4.

United States or a particular state of the United States *discriminates* against banks of all Member States or any particular Member State.

B. *Reciprocity with Respect to Banking Powers*

The Commission in its reciprocity examination pursuant to article 7(5) of the Second Directive is not limited to establishment and acquisition. The Commission may also question whether reciprocal treatment regarding the subsequent operation and the powers of banks in general is ensured in the non-EEC country in question.

Since the powers of U.S. state-chartered banks and state-chartered branches of foreign banks vary from state to state and are not determined by federal law, reciprocal treatment of EEC credit institutions seeking to establish a state-chartered bank in the United States can only be examined with respect to each particular state. Reciprocal treatment of EEC credit institutions seeking to establish a national bank can only be examined with respect to federal law.

The same is true for the EEC. As discussed above, even after the Second Directive has been implemented, the powers of credit institutions will be determined by the authorizing Member State.[140] Accordingly, reciprocity with respect to banking power can be judged only with respect to the banking law of the particular Member State in which a foreign bank seeks authorization for the establishment of a credit institution subsidiary. A reciprocity investigation on an "EEC-wide" basis would lead to absurd results. If a U.S. bank attempts to establish or to acquire a subsidiary in a Member State that does not grant its banks insurance powers, should the Commission deny reciprocity and reject the U.S. bank because another Member State grants its banks such powers when the United States does not? (Insurance powers are not listed in the Annex.)

Even a comparison of the core banking activities set forth in the Annex with the powers granted to national banks in the United States by federal law or to the powers granted to a state bank by state law is not helpful for the reciprocity discussion.[141] If an EEC credit institution desires to engage in an

140. *See supra* notes 54-56 and accompanying text.
141. 12 U.S.C. § 24(Seventh) (1982 & Supp. IV 1986). Section 24(Seventh) sets

activity listed in the Annex, it is not allowed to do so unless it is authorized to conduct such activity by its Home Member State.[142] The Second Directive does not define the powers of EEC credit institutions; its purpose is merely to define the scope of mutual recognition.[143] If a U.S. bank attempts to establish or to acquire a credit institution subsidiary in a Member State that does not permit its banks to underwrite corporate equity or debt securities or to deal in securities, although these powers are listed in the Annex, should the Commission deny reciprocity because the Member State could grant its banks these powers and other Member States have done so? It is difficult to see what purpose an exclusion of the U.S. bank would serve, because once licensed in that Member State, the credit institution could not exercise underwriting or dealing powers on an EEC-wide basis.

If a U.S. bank, however, attempts to set up or acquire a credit institution subsidiary in a Member State that permits its banks to underwrite corporate equity and debt securities or to deal in securities, the Commission might well reach the conclusion that reciprocity does not exist, because a bank from that Member State could not engage in such activities in the United States if it has a deposit-taking facility in the United States. This result is mandated by the Glass-Steagall Act, which has become a focal point of the reciprocity discussion.

In a nutshell, the Glass-Steagall Act was designed to separate commercial from investment banking. It accomplishes this by, among other things, prohibiting banks from underwriting or dealing in corporate debt or equity securities and from being affiliated with companies engaged in such activities.[144]

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forth the powers of national banks. *Id.* The powers of state banks are set forth in the relevant state banking laws. *See, e.g.*, N.Y. BANKING LAW §§ 96-98 (McKinney 1971 & Supp. 1989); *see also* BHCA, § 4(c)(8), 12 U.S.C. § 1843(c)(8) (1982), *amended by* Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, § 502(h)(2), 1987 U.S. CODE CONG. & ADMIN. NEWS (101 Stat.) 522, 628-29, and Regulation Y, 12 C.F.R. § 225.25 (1988) (setting forth activities in which non-banking subsidiaries of bank holding companies may engage).

142. *See supra* note 44 and accompanying text.

143. Second Directive, *supra* note 1, art. 16(1), at 7.

144. Section 16 of the Glass-Steagall Act, 12 U.S.C. § 24(Seventh) (1982 & Supp. IV 1986) (national banks), applies to federal branches and agencies of foreign banks by virtue of § 4(b) of the International Banking Act of 1978, 12 U.S.C. § 3102(b) (1982), and to state branches and agencies by virtue of § 7(b)(2) of the International Banking Act of 1978, 12 U.S.C. § 3105(b)(2) (1982); *see also* § 9(20) of

Recently the Federal Reserve Board has permitted bank affiliates to engage in underwriting and dealing activities with respect to certain limited types of securities, if such activities are limited to less than five percent of such affiliate's gross revenues.[145] Brokerage and investment advisory activities are permitted for banks and bank affiliates.[146]

An analysis of whether an EEC credit institution would be permitted in the United States to engage in each one of the activities listed in the Annex (other than underwriting and dealing) is beyond the scope of this Article. The Annex describes the activities in all-encompassing terms. In each case it would be necessary to determine the exact scope of the activity listed in the Annex. For purposes of finding reciprocity, it should not matter whether an EEC credit institution could engage in the same activities in the United States through a U.S. banking subsidiary or through a non-bank subsidiary of a bank holding company. A finding of reciprocity with respect to each of the activities in the Annex would also require a determination of just how closely the ability to engage in the activity in the United States must "mirror-image" the ability to engage in the same activity in a Member State. Contrary to the broad-brush approach taken by the Annex, the U.S. regulators have excelled in delineating the scope and conditioning the exercise of permitted banking activities and of activities closely related

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the Federal Reserve Act, 12 U.S.C. § 335 (1982); Glass-Steagall Act, § 21, 12 U.S.C. § 378 (1982) (non-member banks).

145. The Federal Reserve Board has determined that if such activities amount to less than five percent of the gross revenues of the bank affiliate over a two year period, the bank affiliate would not be "engaged principally" in underwriting or dealing and would not violate § 20 of the Glass-Steagall Act, 12 U.S.C. § 377 (1982), which prohibits bank affiliation with securities organizations. *See* First Chicago, 74 Fed. Res. Bull. 706 (1988); Bank of Boston, 74 Fed. Res. Bull. 699 (1988); Bank of New England, 74 Fed. Res. Bull. 133 (1988); Citicorp, J.P. Morgan & Co., Bankers Trust N.Y., 73 Fed. Res. Bull. 473 (1987), *aff'd*, Securities Industry Ass'n v. Board of Governors, 839 F.2d 47 (2d Cir.), *cert. denied*, 108 S. Ct. 2830 (1988); Marine Midland Banks, 73 Fed. Res. Bull. 738 (1987); Chemical N.Y., 73 Fed. Res. Bull. 731 (1987); Security Pacific, 73 Fed. Res. Bull. 622 (1987); Manufacturers Hanover, 73 Fed. Res. Bull. 620 (1987); Chase Manhattan, 73 Fed. Res. Bull. 367 (1987).

146. *See* Bankers Trust N.Y., 74 Fed. Res. Bull. 695 (1988); Manufacturers Hanover, 73 Fed. Res. Bull. 930 (1987); J.P. Morgan and Co., 73 Fed. Res. Bull. 810 (1987); National Westminster Bank, 72 Fed. Res. Bull. 584 (1986), *aff'd*, Securities Industry Ass'n v. Board of Governors, 821 F.2d 810 (D.C. Cir. 1987), *cert. denied*, 108 S. Ct. 697 (1988). *See generally* M. CAPATIDES, A GUIDE TO THE CAPITAL MARKET ACTIVITIES OF BANKS AND BANK HOLDING COMPANIES § V (1988).

to banking. A very narrow understanding of reciprocity could deny reciprocity because of the difference between these two approaches. With certain restrictions, U.S. banks generally have the power to exercise, either directly or through bank holding company affiliates, the powers listed in the Annex (other than underwriting of and dealing in securities).

C. *Reciprocity with Respect to EEC-Wide Rights: EEC-Wide Banking*

Only to the extent that the Second Directive grants EEC-wide rights to, or imposes EEC-wide restrictions on, credit institutions authorized in a Member State, can reciprocal treatment be judged against EEC-wide standards. Those standards are mainly the following two: first, the right to establish branches in all Member States[147] and second, the restriction against acquiring companies engaged in non-banking activities.[148]

If the right to freely establish branches throughout the EEC granted by the Second Directive to EEC credit institutions[149] is measured against the restrictions on interstate banking prevailing in the United States, then the U.S. law seems to be more restrictive. State-chartered banks, for example, may establish branches only in states that will accept such branches. As barely any states accept the branches of banks chartered in other states,[150] interstate branching is effectively prohibited. Of course, this situation may change, but only on a state-by-state (and most likely regional) basis. Currently, however, although a chartering state may permit a bank to branch outside the state,[151] interstate branching does not exist.

Similarly, the McFadden Act permits a national bank to operate branches only within its home state and only to the extent that a bank of the same state is permitted to operate

147. Second Directive, *supra* note 1, art. 5(1), at 3.

148. *Id.* art. 10, at 5; *see supra* notes 113-21 and accompanying text.

149. Second Directive, *supra* note 1, art. 5(1), at 3.

150. The Commonwealth of Massachusetts permits banks organized in any of the states of Connecticut, Maine, New Hampshire, Rhode Island, or Vermont to branch in the Commonwealth if such other state permits Massachusetts-chartered banks to branch in its state. *See* MASS. GEN. L. ch. 167, § 39 (1987 & Supp. 1988).

151. New York, for example, permits New York State-chartered banks to establish branches in other states and foreign countries. N.Y. BANKING LAW § 105(3) (McKinney 1971 & Supp. 1989).

branches under state law.[152] Therefore, although a state may allow out-of-state national banks to operate a branch in its state, the McFadden Act would prohibit the national bank from doing so. The McFadden Act does not, however, prohibit national banks from engaging in non-core banking activities outside their home state.[153] Receiving deposits, paying checks, and lending money are core banking activities.[154] A national bank may, therefore, engage in many activities outside its home state, subject, of course, to federal and state regulation of the non-banking activity (for example, securities laws).

A foreign bank that operates a deposit-taking federal or state branch in a particular state, its "home state," is prohibited by section 5 of the International Banking Act of 1978[155] from opening a deposit-taking branch in any other state. However, since EEC law does not require reciprocal treatment for the establishment of Community branches of foreign credit institutions,[156] the U.S. interstate branching restrictions on foreign banks may be of less relevance for the reciprocity discussion.

The so-called Douglas Amendment, section 3(d) of the Bank Holding Company Act of 1956, prohibits a bank holding company or any of its subsidiaries from acquiring, directly or indirectly, any interest in a bank chartered by a state other than the holding company's home state, unless specifically authorized by the statutory laws of the state in which the target is located.[157] The statutory laws of an ever-increasing number of states specifically authorize such acquisitions. At present, the statutes of all but five states permit interstate acquisitions, but the requirements of each vary widely.[158] In an effort to allow

152. McFadden Act, §§ 7(c), 8, 12 U.S.C. §§ 36, 81 (1982).

153. *See* Clark v. Securities Indus. Ass'n, 479 U.S. 388 (1987) (since discount securities brokerage is not a core banking function, office of a national bank at which such activities were conducted was not "branch" within the meaning of 12 U.S.C. § 36(f) (1982) and, therefore, not subject to home-state branch limitations of McFadden Act). National banks may have loan production offices anywhere in the country, as such offices "originate" but do not make loans. *See* 12 C.F.R. § 7.7380 (1988).

154. *See* 12 C.F.R. § 7.7380 (1988).

155. 12 U.S.C. § 3103 (1982).

156. *See supra* note 16.

157. 12 U.S.C. § 1842(d) (1982).

158. *See generally* Bogaard, *Bank Expansion in the Western United States Interstate Compact*, in BANKING LAW AND REGULATION 1988, at 511 (P.L.I. 1988) [hereinafter BANKING LAW AND REGULATION]; Mutterperl, *Current Issues in Interstate Banking: Regionalism*

bank expansion free of competition from the money center banks of New York, these statutes started by lifting the ban on interstate acquisitions within their geographic regions only.[159] This area of law is evolving rapidly. The Second Directive does not authorize EEC credit institutions to acquire a credit institution in another Member State by virtue of its authorization in the Home Member State. However, particular Member States may permit EEC credit institutions as well as their holding companies to acquire credit institutions in several Member States.

The Bank Holding Company Act of 1956 does not restrict bank holding companies from acquiring interests in companies located in other states if the acquiree is engaged in activities that the Board of Governors of the Federal Reserve System has found to be closely related to banking and a proper incident thereto.[160] The state in which the non-banking subsidiary is established, however, may regulate this indirect activity by an out-of-state bank holding company with its banking laws.[161] Many of the activities listed in the Annex are activities that the Board of Governors has found to be closely related to banking.

D. *Reciprocity with Respect to EEC-Wide Rights: Investment in Non-Bank Subsidiaries*

With respect to investments in non-bank subsidiaries, the situation in the United States is as follows: national banks and state member banks are not permitted to purchase any shares of stock and are, therefore, not authorized to establish a subsidiary.[162] The rules pertaining to state banks vary from state

Versus Nationalism, in BANKING LAW AND REGULATION, *supra*, at 499; Prochnow, *Geographic Expansion: Traditional and Nontraditional*, in BANKING LAW AND REGULATION, *supra*, at 505; Smith, *Geographic Expansion: Traditional and Nontraditional Banking*, in BANKING LAW AND REGULATION, *supra*, at 375.

159. *See* Northeast Bancorp, Inc. v. Board of Governors, 472 U.S. 159 (1985) (states may lift the bank holding company's prohibition against out-of-state bank acquisitions according to the discretion of the state legislatures); Brainerd, Northeast Bancorp, Inc. v. Board of Governors: *Green Light for Regional Interstate Banking*, 35 AM. U.L. REV. 387 (1986).

160. *See* BHCA, § 4(c)(8), 12 U.S.C. § 1843(c)(8) (1982), *amended by* Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, § 502(h)(2), 1987 U.S. CODE CONG. & ADMIN. NEWS (101 Stat.) 552, 628-29; Regulation Y, 12 C.F.R. pt. 225 (1988).

161. *See, e.g.*, CONN. GEN. STAT. § 36-5a(d) (1987 & Supp. 1988).

162. 12 U.S.C. § 24(Seventh) (1982 & Supp. IV 1986) (national banks). State

to state.[163] Banks, even if prohibited from owning subsidiaries, may be affiliated with other banks or companies engaged in activities closely related to banking through a holding company. Bank holding companies,[164] however, are prohibited from acquiring and retaining direct or indirect ownership or control of any voting shares of any company that is not a bank, a bank holding company, or an exempted subsidiary.[165] The most important example of an exempted subsidiary is a company the activities of which the Board of Governors of the Federal Reserve System has determined to be so closely related to banking as to be a proper incident thereto.[166] Another very important exemption from the prohibition against investing in non-banks allows bank holding companies to acquire and own not more than 5% of the outstanding voting shares of any non-bank if the bank holding company does not control that company.[167] This exemption does not limit the investment by a bank holding company in shares of a non-bank to a certain percentage of the capital of the bank or of the bank holding company.

By comparison, EEC credit institutions are allowed to make direct investments in companies that are neither credit institutions nor financial institutions.[168]

In case the credit institution acquires or holds ten percent

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member banks are subject to the same restrictions on investment as national banks. 12 U.S.C. § 335 (1982); *see* Gruson, *Investment in Foreign Equity Securities and Debt-Equity Conversion by U.S. Banks, Bank Holding Companies and Foreign Bank Holding Companies*, 1988 COLUM. BUS. L. REV. __.

163. *See, e.g.*, CAL. FINANCIAL CODE § 761 (West 1968); DEL. CODE ANN. tit. 5, §§ 761, 767 (1985 & Supp. 1988); FLA. STAT. ANN. § 658.67 (West 1984 & Supp. 1989); IOWA CODE ANN. § 524.803 (WEST 1970 & SUPP. 1988); N.J. STAT. ANN. §§ 17:9A-24, 17:9A-24.9, 17:9A-25, 17:9A-25.5 (West 1984 & Supp. 1988); N.Y. BANKING LAW § 97 (McKinney 1971 & Supp. 1989); *see* Gruson, *supra* note 162, at __.

164. For the definition of "bank holding company" see BHCA, § 2(a)(1), 12 U.S.C. § 1841(a)(1) (1982).

165. BHCA, § 4(a), 12 U.S.C. § 1843(a) (1982), *amended by* Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, § 101(b), 1987 U.S. CODE CONG. & ADMIN. NEWS 552, 557; *see* Gruson & Weld, *supra* note 133, at 136.

166. BHCA, § 4(c), 12 U.S.C. § 1843(c) (1982), *amended by* Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, § 502(h)(2), 1987 U.S. CODE CONG. & ADMIN. NEWS (101 Stat.) 552, 628-29.

167. BHCA, § 4(c)(6), 12 U.S.C. § 1843(c)(6) (1982); *see* Gruson, *supra* note 162, at __; Gruson & Weld, *supra* note 133, at 131-33.

168. Second Directive, *supra* note 1, art. 10(1), at 5. For the definition of "financial institution," see *supra* note 117.

or more of the capital or voting shares of a non-credit and non-financial institution, or otherwise is able to exercise a significant influence in that institution,[169] such investment is limited to 10% of the credit institution's own funds.[170] All such qualified participations together held by one credit institution may not exceed 50% of the credit institution's own funds.[171]

Whereas U.S. bank holding companies are permitted to have non-controlling interests of up to 5% of the voting shares in a non-bank irrespective of the size of such non-bank, EEC credit institutions may hold up to 100% of the voting shares of a non-bank, if such investment does not exceed 10% of the credit institution's capital and all such investments together do not exceed 50% of the credit institution's capital. It is not possible to determine which approach constitutes the more restrictive treatment. It all depends on whether a bank prefers to make a small investment in a larger company or a larger investment in a smaller company. The underlying policy of both approaches is to ensure the soundness of the investing bank. It is difficult to see why the differences in the non-banking restriction under the two systems should give rise to an argument that reciprocal treatment is not ensured.

Since only a few supervisory standards will be harmonized pursuant to the Second Directive,[172] it appears difficult to see how the Commission can apply a "mirror-image," EEC-wide reciprocity analysis to supervisory standards before allowing U.S. banks to establish credit institutions in the EEC.

E. *Purpose of the Reciprocity Requirement*

It is widely believed that the EEC's intention in requiring reciprocity is principally to protect EEC banks from being denied access to foreign markets in a discriminatory manner.[173] The European Community Commissioner for External Rela-

169. This would be a "qualified participation." Second Directive, *supra* note 1, art. 1, at 3; *see supra* note 102 and accompanying text.

170. Second Directive, *supra* note 1, art. 10(1), at 5; *see supra* note 117 and accompanying text.

171. Second Directive, *supra* note 1, art. 10(2), at 5; *see supra* note 118 and accompanying text.

172. *See supra* notes 90-96 and accompanying text.

173. *See, e.g.*, *EC Single Market Plan Will Bring Partnership, Not a Fortress, Commission Paper Declares: Foreign Bank Eligibility Questioned*, 5 Int'l Trade Rep. (BNA) 1416, 1417 (Oct. 26, 1988).

tions, Willy De Clereq, seemed to support that view when he said, "We are not going to say the United States has to change its banking law. We are not interested in legal equivalence. We are interested in economic equivalence."[174]

Further clarifying his position, De Clereq said that he was concerned about restrictions on European banking activities in Japan and that the Second Directive is aimed against protectionist measures such as they are currently applied by Japan.[175] In connection with his demand for economic equivalence he stressed that the market share of the Japanese banks in the EEC is ten percent, while the EEC banks have less than a one percent market share in Japan.[176] Mr. De Clereq's statement should give little comfort to U.S. banks: the reciprocity requirements of the Second Directive clearly apply to all countries, including the United States. U.S. bankers and regulators might well reread Brothers Grimm's tale about the club in the bag.[177] It is not yet certain whether the reciprocity requirement will be enacted. Members of the U.S. Congress and also interested parties within the EEC (mainly in the United Kingdom and Germany) have argued that the reciprocity requirement should be replaced by a requirement of national treatment. The national treatment requirement generally has the advantage that it is an effective protection against protectionist and discriminatory measures of other countries, while it respects a legitimate degree of national discretion in the regulatory policy. It is a great pity that the United States set a very unfortunate precedent by enacting a reciprocity requirement in the Primary Dealers Act of 1988.[178]

CONCLUSION

It is not clear whether the EEC will wind up with a reciprocity requirement in the Second Directive for the establishment or acquisition of a credit institution by non-EEC institu-

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174. *Commerce Official Warns of Protectionist Potential in EC's Plan for Unified Market: Banking Issues*, 5 Int'l Trade Rep. (BNA) 1338, 1339 (Oct. 5, 1988).

175. *Id.*

176. *Id.*

177. BROTHERS GRIMM, *The Magic Table, the Gold Donkey, and the Club in the Sack*, in THE COMPLETE FAIRY TALES 134 (1987) (BRÜDER GRIMM, *Tischchen Deck Dich Goldesel und Knüppel aus dem Sack* in DIE KINDER- UND HAUSMÄRCHEN (1812)) (KHM 36).

178. *See supra* note 132.

tions and, if so, whether it will construe such a requirement very narrowly to prohibit institutions from countries with different bank regulatory policies access to the banking market in the EEC. It is difficult to see how the Commission would apply such an EEC-wide "mirror-image" reciprocity requirement, because in fact the Second Directive does not harmonize the banking laws of the different Member States. It is hoped that the EEC's intention is merely to protect EEC banks from being denied access to foreign markets in a discriminatory way.

However, non-EEC banks that have a subsidiary in a Member State that is authorized as a credit institution before the entry into force of the Second Directive benefit from the Second Directive without being subject to the reciprocity requirement. It would, therefore, be advisable for a non-EEC bank intending to participate in the EEC market to have an EEC credit institution subsidiary in place before the Second Directive is enacted and certainly before 1992.

Non-EEC banks wishing to establish or acquire an EEC credit institution in order to benefit from the Second Directive will have to choose the Member State in which to do so. This decision will mainly be determined by three questions:

1) How broad are the banking powers in the Member State in question?

2) What is the business environment and infrastructure that the Member State in question can offer?

3) What is the tax situation in the Member State in question?

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

Finally, since each EEC credit institution will be able to provide services throughout the EEC, the Second Directive raises the question whether a non-EEC bank already having more than one credit institution subsidiary in the EEC should merge its subsidiaries into a single institution that can offer its services throughout the EEC and establish branches in other Member States.