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I. INTRODUCTION

The key element for financial integration in the European Community ("EC" or "Community") is the liberalization of capital movements, which is closely linked with the freedom to provide financial services. In 1962, the Community adopted legislation requiring Member States to allow free movement of capital for direct investment. The Council of Ministers took a major step in 1986 when it adopted a directive requiring the Member States to liberalize long term commercial transactions, bond issues and unquoted securities. In June 1988, the Council of the EC Finance Ministers decided to liberalize, by the end of 1990, the remaining capital transactions, including those involving short term monetary instruments, personal bank accounts, and purely financial loans. This directive also provided a liberalization of capital flows towards the outside world. The Commission recently adopted a proposal aimed at establishing a minimum tax for savings. Finally, as part the Community's strategy to complete the Internal Market by 1992, it has proposed the creation of a unified banking market founded on the principle of mutual

* Member of the Directorate for Financial Institutions, D.G. XV Commission of the European Communities, Brussels. The author has been involved in the drafting and presentation of a proposal for a Second Banking Coordination Directive. He is currently involved in the negotiations for its adoption.


2 Tax Measures to be Adopted by the Community in Connection with the Liberalization of Capital Movements, COM (89)60 final (Feb. 8, 1989).

3 Completing the Internal Market: White Paper from the Commission to the European Council, COM(85)310 final (June 14, 1985)[hereinafter White Paper].
recognition and a single banking license valid throughout the Community.

The aim of this Article is to outline and assess the Community’s strategy for the banking sector by highlighting the philosophy and the context shaping its actions. In addition, this Article will attempt to show that the Commission’s various proposals, particularly the Second Banking Coordination Directive (“Second Directive”), take account of the continuing tension of, on the one hand, achieving more efficient banking systems through increased competition and, on the other hand, the absolute need for prudential supervision, enhancing the financial stability of the banks and public confidence in the banking systems. Finally, this article looks at the Community’s policy towards the rest of the world.

II. THE STRATEGIC CONCEPTS OF BANKING INTEGRATION

The Community’s policy in the banking field consists of three fundamental features: the harmonization of banking regulation, the mutual recognition of financial standards, and the home country control principle. This section will examine each of these features in turn.

A. The Harmonization of the Essential Aspects of Banking Regulation

One of the long-term efforts of the Community has been the harmonization of the banking regulations in the Member States. However, the meticulous harmonization efforts in the banking field have proven to be, in many respects, impractical and cumbersome. This experience coupled with the urgency of completing the common banking market by 1992 has prompted the Commission to shift its policy emphasis. The Commission has adopted as its main tool for integration in the financial field the harmonization of banking legislation and the mutual recognition of supervisory standards. The harmonization of the essential elements of the regulations of the Member States includes the aspects regarding the soundness and stability of banks and other financial institutions.4

B. The Mutual Recognition of Financial Standards

The concept of “mutual recognition” endorsed in the White Paper in 1985 constitutes a major integration technique in the financial field.5

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4 It is worth emphasising that even though the White Paper refers to “minimum harmonization” of prudential standards, it is not to be construed as an endorsement of the lowest common denominator and alignment to the most relaxed supervisory standards of any Member State. Zavvos, The Banking Perspective of 1992, EUR. AFF., Jan. 1988, at 100.

Since it is enshrined in the EC Treaty provisions concerning professional qualifications, this concept was already known in Community law. In addition, prior to the adoption of the White Paper, the Commission had proposed a mortgage credit directive based entirely on this approach. The concept of mutual recognition linked with harmonization and home country control has reversed the traditional trends and has accelerated considerably the decisionmaking process particularly in the banking sector.

Mutual recognition is consistent with the Community’s open market philosophy which advances that its power should be activated only where it should deliver a “public good” (e.g., protection of depositor or investor, safety and stability of the financial system) which cannot be effectively ensured at a national level. At the same time, the free play of the market forces will determine the value of more costly regulatory standards.

C. The Home Country Control Principle

The third major component of the Community’s strategy is the principle of “home country control.” All the activities of banks and other financial institutions carried out through branching or on a cross-frontier provision of services throughout the Community’s territory, in principle, will be supervised by the competent authorities of the Member State of the institution’s head office. To this very important rule are attached three exceptions justified by the current degree of coordination of national economic and monetary policies in the Community. The host authority will be responsible for the supervision of liquidity and the monitoring of the monetary policy and provisions regarding the market risk related to securities. In addition, the relevant Community directives have created the necessary framework ensuring, among other things, the cooperation of the competent authorities of the Member States in the field of banking supervision.

III. THE SECOND BANKING DIRECTIVE

A. The Single Banking License and the List of Banking Activities

The most “revolutionary” feature of the proposal for a Second Directive are the endorsement of the concept of the single banking license and an agreed list of “banking activities.” This system provides the passport for European banks through which they may receive the benefit of mutual recognition. However, the banks must comply with the two cumulative requirements. Initially, they must be authorized and supervised
by the competent authorities of their home states, according to the provi-
sions of Community banking directives. Additionally, they must under-
take activities which appear on an agreed list which is annexed to the
proposed Second Directive. This mechanism implicates three major
considerations.

The first consideration is a geographical deregulation of the banking
business. A single banking license will ensure full interstate branching
and provision of banking services because of the very notion of the single
banking license. By the end of 1992, Member States should abolish the
authorization requirement on branches of Community banks (Art. 5).
Another important consequence is the gradual abolition of the endow-
ment capital for branches, currently required by every member state ex-
cept Great Britain (Art. 5, § 2). Thus, EC banks, freed from
administrative and financial impediments, will be able to expand their
business in the Internal Market.

The next consideration is product deregulation. The Second Direc-
tive will contribute to the widespread acceptance of a “universal type” of
banking throughout Europe. In fact, the most interesting aspect of the
list annexed to the Second Directive is that it includes not only all the
traditional commercial banking activities (deposit taking and mortgage
credit) but also all forms of transactions in securities. More specifically it
includes: (1) trading for own account or account of customers in all
forms of security (short and long term); (2) participation in share issues
and the provision of services related to them; and (3) portfolio manage-
ment and advice.

The Commission’s proposal takes into account market realities and
the growing blurring of demarcation lines between traditional commer-
cial banking and investment banking. The list will be subject to periodic
review according to flexible procedures cognizant of new techniques
brought about by financial innovation. Thus, within such a regulatory
framework market forces will determine the choice between “universal”
or “specialized” banks. If the latter promptly find their “market niche”
they will likely profit from the benefits offered by the vast unified market

The final consideration involves efficient, but indirect deregulation
methods. There is a justified expectation that the new Community strat-
ey enshrined in the Second Directive will have a major deregulatory
impact on the most restricted banking systems in the Community; that is,
systems which maintain the model of fragmented financial systems and
allow banks to provide only limited services. This conclusion stems from
the range of activities included in the list. According to the new deregu-
ulatory concept of the Commission, Member States will be obliged to allow any credit institution from another Member State to provide the full list of its activities if it has been authorized and is supervised in this respect by the competent authorities of its home country. This result is true even if domestic banks are not allowed, by virtue of their national legislation, to undertake the same range of activities.

The provisions of the Second Directive do not impose upon Member States the obligation to let their domestic banks perform all these activities. In other words, a Member State may, hypothetically, want to allow its own banks to engage in only some of the activities. However, if a Member State chooses to do so, this could give rise to reverse discrimination against domestic banks. Given the realities of the banking sector, it would be difficult to envision any national authority opting for this discrimination. The forces of competition and the realities of the banking industry itself will drive Member States to adopt this deregulatory trend.

IV. REINFORCING BANKING SUPERVISION IN THE EUROPEAN COMMUNITY

The benefits of competition notwithstanding, the Commission has taken the position that a higher degree of regulation is justified for the smooth functioning of financial markets as compared with the regulation necessary for manufacturing or commercial markets. Financial markets rely heavily on the confidence of the public. The value of financial services is highly dependent on the public’s perception of the stability of the specific financial institution and the entire financial system. It is not always true that stability is best served by the free play of market forces. Unlimited competition can sometimes produce instability. The stability of the financial system should be considered as a public good, safeguarded by regulatory action. In addition to the above economic considerations, the Commission’s actions are justified, to a great extent, by the Treaty of Rome, which provides for the protection of savings (Art. 57, § 2).

A. Harmonization of Licensing Conditions

One of the major goals of the Second Directive is to complete the essential harmonization of banking supervisory systems and, more particularly, the harmonization of licensing conditions which are necessary to secure the mutual recognition of the supervisory systems, paving the way for a single banking license recognized throughout the Community. The current proposal introduces the provision that, in order for credit institutions to obtain authorization, they must have initial capital of at
least five million ECUs. This provision ensures that Community banks which undertake cross-border business should have sufficient initial capital (Art. 3).

Effective supervision of a credit institution by the competent authorities implies *inter alia* that they should be able to exercise some supervision over the important controlling interests in the institution. This supervision should extend to both banking and non-banking entities. This is the reason why the Second Directive enables the competent authorities to obtain the necessary information regarding the identity and the interests of major shareholders applying for a banking license or envisioning the acquisition of a credit institution already in operation (Art. 4 and 9).

The efficient supervision of credit institutions' participations in non-credit and non-financial activities requires special attention in the interest of the financial stability. It is widely acknowledged that participations in a non-banking subsidiary may affect the soundness of a credit institution if the former runs into financial difficulties. This is commonly known as contagion risk. In addition, equity participations constitute a long-term freezing of the assets of credit institutions. In this respect, the Second Directive incorporates rules requiring banks, as a principle, to fulfill certain objective criteria if they wish to acquire or maintain participations in non-credit or non-financial institutions. This directive endorses two prudential limits: (1) that a credit institution should not hold an interest in an undertaking exceeding 10% of the amount of funds available to the institution for meeting capital adequacy requirements ("own funds") which is neither a credit nor a financial institution, and (2) that the total value of such participations should not exceed 50% of its own funds. Some Member States whose banks are allowed widespread participation in the non-banking sector (e.g., Germany, Spain, Greece) encounter particular difficulties in endorsing these rules.

The smooth functioning of the Internal Market in banking will require close and regular cooperation between the competent authorities of the Member States. One of the major features of the Second Directive is the strengthening of cooperation between the banking supervisory authorities of the Member States. This includes the right of home authorities to conduct on spot verifications for their banks' branches in other Member States. Specific rules reinforce the professional secrecy obligation branches of these authorities.

B. Solvency Ratio and Capital Adequacy

The enforcement of the rules of prudential supervision includes
more than the harmonization of bank licensing conditions and the cooperation between European banking supervisors. It is also closely interlinked with a series of other measures which should come into force by the end of 1992. The measures include the harmonization and reinforcement of the capital adequacy of banks and the introduction of deposit guarantee schemes and rules on large exposure.

The Commission has tackled capital adequacy in two stages. The Council adopted at the end of 1988 its common position regarding the directive establishing a supervisory definition of the own funds of credit institutions; and the own funds so defined form the numerator of the solvency ratio proposal which was presented to the Council in April 1988, and is currently under negotiation. The latter proposal defines the items of the denominator, establishes methods of calculation and procedure, and proposes a minimum level for the ratio.

Another general observation is that the risk-asset based approach which the Commission has developed is very similar to that developed in the Cooke Committee, the Committee made up of representatives of the central banks of ten major industrial countries ("Group of Ten") and meet regularly in Basle, Switzerland. This is not a coincidence. Both approaches have their origin in the early 1980s and have borrowed from each other both before and after 1987 when the pace of work accelerated in both Brussels and Basle. In the latter stages, the borrowing and convergence was actively promoted by both the Cooke Committee and the Commission, and supported by the European banking industry. From the Commission's viewpoint, if it can achieve both the pre-conditions for the completion of the Internal Market and the adoption of common standards on an international plane, it will have met two extremely important goals at the same time. Both these achievements would promote greater competitive equality and systemic stability.

The EC proposal contains a minimum figure of 8%, the same as Basle's figure, on a provisional basis. It was arrived at on the basis of a series of trial, observation ratios carried out over a number of years and

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7 The Cooke Committee is the common name for the Committee on Banking Regulations and Supervisory Practices. The name was taken from the Committee's chairman, Peter Cooke, a Bank of England official. The Cooke Committee is made up of representatives of some of the central banks belonging to the Bank of International Settlements ("BIS"). These countries are the United States, the United Kingdom, France, West Germany, Italy, the Netherlands, Belgium, Sweden, Canada, and Japan (the "Group of Ten"). The Cooke Committee meets regularly in Basle, Switzerland, to discuss international financial matters. See Fay, Central Bankers Have a Hotline Too, FORTUNE, Oct. 1, 1984, at 138-42.
The solvency ratio will apply to all EC credit institutions, subject perhaps to some exemptions for specialized institutions, and in this respect potentially differs from the Basle recommendation. Basle’s focus has traditionally been on large internationally active banks, but there seems to be a trend for non-EC Members of the Group of Ten to think in terms of applying the Basle framework to a wider range of banks and financial institutions. The federal authorities in the United States have certainly proposed such scope, and other authorities will do the same.

There is one other noteworthy feature which does not constitute a divergency in the two approaches, but which makes progress and refinement in the Community rather easier than in a wider international context. This is the harmonization of bank accounting definitions and techniques in the Community agreed in a Directive at the end of 1986. This presents common ground, not only on items such as valuation techniques, but also in relation to the particularly troublesome boundary line between reserves and provisions and the distinction between specific and earmarked provisions.

V. SECURITIES: Deregulating the Investment Services Market

As was pointed out previously, the Second Directive has an important bearing on investment services in the securities markets field. However, this proposal has an institutional rather than functional approach in so far as it relates to credit institutions, but not to other types of business organizations. At the end of 1988 the Commission adopted a proposal for a Directive regarding the liberalization of services of investment intermediaries. The aim of this instrument was to lay down an authorization procedure for any person wishing to provide one or more of the services falling within the directive's scope, such as brokering, dealing, or portfolio management. In other words, the Directive proposed a single banking license. Based on this authorization, an investment firm will be allowed to provide services on a cross-border basis within the Community without needing to be authorized in any of the other Member States. Thus, the Directive will apply the fundamental principle of home country control to the field of securities, in addition to the principle of a single license and an agreed list of banking activities covered by the license.

In other words, this new Directive will extend to non-banking insti-
tutions the same freedoms which are provided by the Second Directive to banks. It should be made clear, however, that for investment firms which are banks and already authorized under the Second Directive to carry out securities related activities, no further authorization will be needed under the Investment Services Directive. The Commission has started working on a proposal to ensure that both banks and non-banks provide adequate capital in relation to their securities-related business.

The Community approach to the integration of financial markets, based on mutual recognition and home country control, requires an essential degree of coordination of prudential standards prior to establishing a single license. This is true in integrating both the banking and securities markets. Thus banking or securities services will be provided on a cross-frontier basis only by duly licensed and adequately supervised institutions. Having in mind the experience of the banking sector, most would agree that the standards which will be applicable to the securities field will be high enough to safeguard the interests of investors. The Commission believes that, since financial markets rely primarily on the confidence of the public, a higher degree of regulation is indispensable for the smooth functioning of the markets. As experience shows, businesses are attracted, not deterred, by high quality and high standards in securities regulation.

Finally, it has become apparent that the supervision of securities markets requires international cooperation. Such cooperation has already been established in the framework of the Banking Advisory Committee in Brussels and in the Cooke Committee in Basle. It is important that this cooperation is reinforced between Community securities supervisors especially when negotiating with third countries. This would be a particularly important contribution to the international trends for the cooperation of securities supervisors for which the EC thinks is absolutely necessary.

VI. THE EUROPEAN COMMUNITY’S POLICY IN AN INTERNATIONAL PERSPECTIVE

A. The Issue

The Second Directive provides in article 7 for a reciprocity clause which is designed to apply to subsidiaries of third country undertakings seeking banking licenses in the Community or intending to acquire part of a credit institution already operating in the Community. The same type of reciprocity clause has been endorsed recently in the proposals for Directives regarding investment services in the field of securities and the free provision of services in the field of life insurance.
While the inclusion of a reciprocity clause in a Directive on the financial sector is not new, the Second Directive is the first time that the Commission uses it with regard to the first establishment of foreign undertakings. In fact, previous Directives specified reciprocity as a criterion which should be considered when the Community or the Member States concluded an agreement with a third country in a particular field.  

It may be worth distinguishing between the term “establishment” used in article 52 of the Treaty of Rome and the term “first establishment” used here. The latter is relevant only for third country undertakings (i.e., incorporated in a non-Community country) wishing to operate in the Community by establishing a subsidiary or opening a branch or an agency in a Member State.

Though reciprocity constitutes an approach extended to the whole spectrum of Community financial law, in the present context we will deal with certain policy and legal aspects of the reciprocity clause regarding the Second Directive which have attracted international attention.

B. Rationale for the Endorsement of the Reciprocity Clause

I. Single Banking License and the Community’s Legal Framework Governing First Establishment

As has been observed previously, the granting of the single banking license will have an immediate impact not only for the Member State of the first establishment of the third country bank but also for all the other Member States. Owing to the far reaching effects of this license, the admission of a third country bank’s subsidiary in one Member State carries with it an admission to the whole Community’s banking market. As things stand in Community law, third country banks which establish their subsidiaries in any Community country are considered as Community undertakings as of the moment of their incorporation and therefore may benefit from the right of establishment (Art. 52) and the right to provide services (Art. 59). This approach has its legal basis in article 58 of the Treaty.

In this respect, it is very important to draw a distinction between

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10 “Companies constituted in accordance with the law of a Member State and having their registered office, central management or main establishment with the Community shall, for the purposes of applying this chapter, be treated in the same way as natural persons who are nationals of Member States.” Treaty Establishing the European Economic Community, 298 U.N.T.S. 3, 40, (1958), art. 58 [hereinafter Treaty of Rome].
subsidaries and branches, because branches\textsuperscript{11} of third country banks cannot benefit from the above mentioned Treaty provisions. Branches do not represent an autonomous legal entity, but rather they constitute an extension of the principal business. Therefore, the branch may operate only within that Member State. Although Member States have total freedom to allow the cross-border provision of services from a third country on their own territory, the right of free provision of services across national boundaries embodied in the Treaty of Rome does not extend to these services.\textsuperscript{12}

In conclusion, the subsidiary of a third country bank established in a Member State is legally considered to be to a Community bank and may enjoy the same benefits accruing from the single banking license. Other Member States are bound to allow this institution to operate in their territory through branching or direct provision of services, without requiring a license or endowment capital, and without limiting the range of services provided in the home State. In the Commission's view, this is why this common stance of the Member States regarding the first establishment was necessary.

2. \textit{The Ongoing Negotiations of the Uruguay Round}

The ongoing negotiations of the Uruguay Round were the second major reason for the Community's policy regarding reciprocity. Indeed, the Community sees an important underlying link between its efforts to establish the Internal Market for financial services and the GATT negotiations, which, among their other goals, also strive to liberalize the trade in financial services. In other terms, the Community intends to use its internal financial market as a stimulus and a negotiating tool on the most restrictive countries which need to further liberalize their financial markets. This is the second reason for introducing a reciprocity clause emphasizing its deterrence impact. In any case, the fact that there are currently no international rules regulating banking activities cannot be ignored.

\textsuperscript{11} The term "branch" is defined 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 to the business of credit institutions." First Banking Directive, \textit{supra} note 9, at Art. 9.

\textsuperscript{12} Article 59, § 2 of the Treaty of Rome provides that "The Council may, acting by a qualified majority on a proposal from the Commission, extend the provisions of the charter (Services) to nationals of a third country who provide services and who are established within the Community." Until now the Commission has not made any proposal. Treaty of Rome, 298 U.N.T.S. at 40-41, art. 59, § 2.
3. The Policy of the European Community Towards Third Countries

Article 7 of the Second Directive has been criticized as a provision which by endorsing a reciprocity clause is fostering protectionism and may result in the Community raising barriers and creating the so-called "Fortress Europe." Thus, before systematically examining the key aspects of the reciprocity clause, it may be helpful to review some of the parameters defining the Community's policy towards the outside world and to bear in mind some policy and legal considerations.

First, there is an increasing interdependency of the Community and the outside world in terms of trade. This is a factor of crucial importance in all Community policy. Second, the Community traditionally follows a liberal financial policy and is undoubtedly one of the most open financial markets in the world. Hundreds of banks and other financial institutions of third countries are already established in practically every Member State. At the same time, the Community's banks and other financial institutions are established in many third countries.

Third, it has been alleged that the reciprocity clause proposed in the Second Directive might hamper direct investment in the Community. In this respect it should be borne in mind a significant distinction which is frequently blurred. The reciprocity clause stipulated in the Second Directive relates only to subsidiaries and not to branches of undertakings governed by the laws of a third country. In other words, even if the establishment of a banking subsidiary of an undertaking which is established in a third country is covered by the reciprocity clause, nothing prevents this undertaking (if it is a bank) from establishing banking branches in all twelve Member States, if the latter's authorities are willing to grant the license.

Fourth, it is well known that the key component in the field of financial integration is the directive liberalizing the movement of capital, granting free access to the capitals of residents of third countries, the so-called freedom "erga omnes", the right to invest anywhere in the Community. Finally, reciprocity clauses are endorsed in several international agreements, like the Organization for Economic Cooperation and Development ("OECD"). More particularly, the code on capital movements provides that it is legitimate for individual OECD members

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15 For the purposes of the Organization for Economic Cooperation and Development ("OECD") codes, the status of measures and practices concerning reciprocity is regarded as different from that of restrictions that can be the subject of reservations. Pursuant to the codes these measures must be reported to the organisation, and entered on an ad-hoc list.
to exercise a control over the access of new foreign firms to the national market in financial services such as banking and insurance. In addition, at least twenty out of the twenty-four OECD Members have launched formal reservations to the capital movements code in respect of such reciprocity clauses. Needless to say, reciprocity clauses have been always an object of discussion in the context of GATT negotiations. In other terms, the adoption of a reciprocity clause, especially in the banking and more generally the financial field, is viewed and used by the majority of the most financially developed countries as a means for opening restrictive foreign markets, not creating more barriers to international trade.

D. The Meaning of Reciprocity

On October 19, 1988, the Commission, in an important communique, clarified some of the most crucial issues regarding the external aspects of its policy relating to the accomplishment of the internal market. By highlighting the major issues of its policy the Commission pointed out that:

For 1992 as for the other steps, the Community's aim is to strengthen the multilateral system in accordance with the concept of balance of mutual benefits and reciprocity.

It added that:

the Commission reserves the right to make access to the benefits of 1992 for non-member country firms conditional upon the guarantee for similar opportunities or at least non-discriminatory opportunities in those firms' own countries. This means that the Community will offer free access to 1992 benefits for firms from countries whose markets are already open or which are prepared to open up their markets on their own volition or through bilateral or multilateral agreements.

There is no generally accepted concrete definition of “reciprocity” in domestic laws or international agreements. The broad terms frequently used in the various texts take a concrete meaning only though their enforcement by the competent authorities. The Second Directive does

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16 J. JACKSON, WORLD TRADE AND THE LAW OF GATT 240-45 (1969). The OECD code on capital movements provides that OECD members are required to allow from other member “to invest or establish on the Member Country concerned under terms similar to those applied by the other Member Country to investors resident in the Member Country concerned.”


18 Certain slow progress was achieved in this field in the United States, particularly through the series of decisions adopted by the Federal Reserve Board to allow banks to enter in the securities business. The Federal Reserve Board announced on Jan. 18, 1989, that it had conditionally approved applications by J.P. Morgan, The Chase Manhattan Co., Bankers Trust, Citicorp and security Pacific Corporation to engage to limited extent in additional securities underwriting and active dealing. Fed Moves to Allow Banks to Underwrite Corporate Debt; Equity Powers Withheld, Wall St. J., Jan. 19, 1989, at A3, col. 2.
First, the Commission will take into account the degree of development of the third country concerned when applying reciprocity. Thus, the Commission pointed out that reciprocity “does not mean that all partners must make the same concessions nor even that the Community will insist on concessions from all its partners.” In other words, the Commission, by applying this clause to developing countries, will not require concessions which are beyond these countries’ means.

Second, the Commission does not intend to apply mirror reciprocity, i.e., asking its partners to adopt legislation identical to its own. This qualification has particular merit for the banking sector, which expressed doubts as to whether the Community might make access to banks in third countries dependent upon those countries’ willingness to adopt identical financial regulation, such as those relating to full interstate and universal banking. In any case, it would be unrealistic for the Community to expect that its major partners mirror completely the prudential rules and supervisory systems adopted in the European Community. It is widely acknowledged that such harmonization would encounter enormous difficulties from the Constitutions and laws of the third countries.

Third, with respect to the banking sector, the Commission emphasized that it does not intend to give the reciprocity clause a retroactive effect. More specifically, it pointed out in its communique that “the Second Banking Directive provides for the possibility of reciprocity for newcomers.” However, there can be no questions of depriving the subsidiaries of foreign firms already established in Community Member States of the rights they have acquired. This significant political statement ended the speculation regarding the Community’s policy on reciprocity towards banks already established in the Community.

E. The Need for Regulatory Symmetry in the Global Financial Market Place

The eventual application of a reciprocity clause may be contrasted against the background of regulatory asymmetry existing particularly between the major financial centers. Two types of regulations do more than anything else to destroy the smooth functioning of the global market place. The first type exacerbates the problems stemming from segmented financial systems which results from maintaining a division between commercial banking and investment banking. An example of this is the Glass-Steagall Act of 1934, which prevents banks in the United
States from underwriting securities issues.\textsuperscript{19} It is rather awkward that some of these countries allow their banks to pursue joint activities abroad which they are not allowed to pursue at home. The second type of restriction destructive to the market place relates to the geographical expansion of banks, such as the McFadden Act, which restricts interstate banking in the United States.\textsuperscript{20}

On the other hand, the Community banks, as well as established banking subsidiaries of third country banks, will benefit from full universal and interstate banking, and have the right to full branching by 1992. If the banking systems of the major international financial nations do not move in the same direction, this might be a significant handicap for the international banks abiding by equivalent standards.

Given the fast pace of globalization, if these structural irregularities are not ironed out, they could greatly disrupt the smooth functioning of the market. It is interesting to note that some acknowledge a beneficial effect of the EC reciprocity clause in helping the domestic legislative bodies of segmented financial systems to advance to further liberalization of their domestic financial system.\textsuperscript{21}

\section*{F. Defining Reciprocity in Practice: Towards a Functional Approach}

Undoubtedly this is one of the areas where the test of reciprocity should be defined more concretely. The Commission has declared that, in GATT negotiations, its objective is to obtain “comparable levels of market access.” It can be argued that this EC approach is not different from the approach the United States took in its Omnibus Trade Act, which attempts to achieve reasonable comparability in the types of financial services permissible for financial services companies.\textsuperscript{22} Both these approaches could be termed as equivalent treatment which, for regulated fields such as banking, cannot mean identical treatment, which would imply a complete harmonization of banking regulations.

Any realistic observer of international banking relations will acknowledge that the GATT negotiations will certainly be focused on promoting the liberalization concept on unrestricted access (or right of establishment in the Community’s legal jargon) and national treatment (that the host country will not discriminate against foreign-owned bank

\begin{itemize}
  \item \textsuperscript{19} 12 U.S.C. § 378 (1982).
  \item \textsuperscript{20} 12 U.S.C. § 36(c) (1982).
  \item \textsuperscript{22} Omnibus Trade and Competitiveness Act, Pub. L. No. 100-418, 102 Stat. 1387 (1988), § 3602.
\end{itemize}
or financial institutions established in any country compared with domestic competitors). Indeed, these two twin concepts will give a satisfactory arrangement in most of the cases. However, in certain cases, particularly in negotiations between OECD countries—negotiations might have more ambitious goals, because the right of establishment and national treatment are not always sufficient to ensure comparable market opportunities. The Community's experience in creating a Common Market is very instructive in this respect. The non-discriminatory applications of national rules and regulatory regimes may—for various reasons—disadvantage providers of services and goods to other Member States. The Second Banking Directive, based on the principle of the minimum harmonization and mutual recognition, goes beyond the principle of national treatment. These effects will be so far reaching that, as was discussed above, EC banks which have the single banking license will be allowed to carry out the same activities throughout the Community, even in Member States whose supervisors prevent their own national banks from engaging in those activities.\(^{23}\)

\(^{23}\) As this Article was going to the presses, the Commission decided on April 13, 1989, to adopt more flexible procedures regarding article 7. However, the Commission retains the power to use the reciprocity clause whenever it determines “that credit institutions of the Community do not enjoy national treatment and the same competitive opportunities as domestic credit institutions in a third country, and that the condition of effective market has not been secured.” (emphasis added). In that case, the Commission may, in addition to other means it has at its disposal, “decide that the competent authorities of the Member States shall limit or suspend their decisions regarding requests for new authorizations and acquisitions by a parent undertaking governed by the third country. . . .”