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The Investment Services Directive and its Implementation in the EU Member States

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Abstract

With the entry into force of the Investment Services Directive (ISD) on January 1st 1996, a major move has been made towards the integration of capital markets, by ensuring the cross-border mobility of the intermediaries on the market. This paper examines to which extent the ISD has actually contributed to realising a single European capital market, and how the member states have in general implemented the directive.

*Attention is also paid to future developments in the field of capital market regulation and market developments (*inter alia *the advent of European Monetary Union, the alliance movement between stock-exchanges and regulated markets, and the demutualisation of the stock exchanges.*

Finally we examine whether the mutations brought about by EMU and technological developments in financial markets should lead to further modifications to be made to the European Directives in the field of capital markets.

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The Investment Services Directive and its Implementation in the EU Member States

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Introduction

The Investment Services Directive of 11 May 1993 (the 'ISD') constituted, in the field of financial regulation, the last important directive for the establishment of the European Internal Market for banking and financial services, which was supposed to be fully in force on January 1st, 1993. The delay suffered in the adoption of the ISD illustrates the difficulties surrounding the liberalisation of the financial markets in several member states, and the problems in reaching common standards in an area of regulation which until then was largely embedded in national traditions and protection of domestic markets against the forces of competition. As a result, the provisions of the ISD show on different key issues the traces of compromises, which in some cases will have the effect of slowing down the process of liberalisation.

Notwithstanding the difficulties in the adoption process, the implementation of the ISD in the Member States demonstrates the strong impact of the directive in fostering competition between regulators. Though financial markets are globally operating under the strains of enhanced international competitive pressure, these forces seem to be heavily amplified within the European Union after the adoption of the ISD. This may at first sight seem paradoxical, as the ISD was primarily concerned with the international mobility of the *intermediaries* acting on the markets, and not of the securities *markets* themselves. However, the access of the financial intermediaries to the markets in other member states was considered an important corollary of their right of establishment and freedom to provide services. Hence, the international mobility of the intermediaries would also provoke a stronger interpenetration of the markets. This also explains why much of the debates and controversies in the preparation of the directive focused on the regulation of the markets.

It may be submitted that the increased competition between securities markets, exemplified by the important financial market reforms realised in several member states in the course of implementation of ISD, is not only the result of the liberalising effect of ISD, but, maybe more important, by the anticipation by both industry and the regulators to the introduction of the euro in stage three of Economic and Monetary Union (EMU).[1]

The aim of this chapter is to describe and analyse the ISD and its effects on the regulation of the financial intermediaries and markets in the Member States. After an outline of the main provisions of the ISD and the consequences of its basic legal principles on the liberalisation process (part I), we will look at the general features of the implementation in the member states, as illustrated through the post-ISD situation in some of the major financial centres (part II). In a few concluding remarks we will briefly comment on some legal issues involved with possible future developments in the securities markets in the aftermath of ISD and the realisation of monetary union.

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[1] Compare FRANKEL, J.A., "Exchange Rates and the Single Currency", in *The European Equity Markets, The State of the Union and an Agenda for the Millennium,* B. STEIL (ed.), London, RIIA, 1996, p. 393: "Monetary union may (...) act as a far more powerful force for liberalising European market structure than any directive ever could".

Part I. - General Overview of the Investment Services Directive

A. Genesis of the ISD

As already pointed out, the adoption of the ISD at the level of the EU Council was a difficult process. Already in 1989 did the European Commission submit a first proposal to the Council[2], which after a first discussion in the European Parliament[3] and consultation of the Economic and Social Committee[4], led to a new proposal by the Commission in 1990.[5] It then took almost three years to have the proposal adopted in second reading by the European Parliament[6] and finally by the Council of Ministers on 10 May 1993.[7] It is useful to briefly recall the main issues obstructing the smooth adoption of the directive.

1. The 'level playing field' issue

A first obstacle related to the issue of competitive equality between credit institutions and investment firms when both would be offering similar services to investors. On the one hand, the specialised intermediaries in the field of investment services called for the entry into force of the ISD at the same time as the Second Banking Directive (on January 1st 1993), such as to equally be entitled to the European passport. More important however was the issue of equality in the regulatory burden for both types of institutions in the carrying on of their investment activities. From the part of securities brokers and other specialised intermediaries, it was feared that credit institutions would be able to supply investment services under less stringent capital requirements or other obligations, such as conduct of business rules. The industry therefore lobbied to have part of the provisions of the ISD and of the Capital Adequacy Directive (CAD) applied to credit institutions. As for the latter rules, an outcome for the technical issue of level playing field was found in creating, as far as credit institutions are concerned, the distinction between the banking book and the trading portfolio. The securities held in the course of normal trading activities by credit institutions were then subject to the same capital adequacy rules as for investment firms, while the securities held as part of the banking book would be excluded from the market risk approach of the CAD, and be included in the 'normal' banking capital rules coping with credit risks (Cooke ratio).

On the other hand, credit institutions could suffer competitive disadvantages as a result of the 'lighter' regulatory requirements imposed on investment firms, *inter alia* in terms of initial capital or organisation of the business. As a counterweight, the banking industry pressed to restrict the scope of allowed activities for investment firms. The distinction between core and non-core investment services in the annex to the ISD has to be regarded in this perspective: while both types of activities can fall within the scope of the Banking passport and be fully deployed in other member states by credit institutions, some of the non-core investment services (e.g. forex, credit activity etc.) are considered ancillary to the core services as far as investment firms are concerned: for these non-core services, an investment firm can use its European passport only for offering them in connection with

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[2] OJ, C 43 of 22 February 1989, p. 7
[3] OJ, C 304 of 4 December 1989, p. 39.
[4] OJ, C 298 of 27 November 1989, p. 6.
[5] OJ, C 42 of 22 February 1990, p. 7.
[6] OJ, C 115 of 26 April 1993.
[7] OJ, L 141 of 11 June 1993, p. 27.

core investment services. There is no similar requirement for the other non-core services (e.g. investment advice, safe custody services), but using the European passport in another member state for the sole purpose of offering a non-core investment service could qualify as an abuse of the European passport.[8]

2. Competition between markets

In the opinion of the European Commission, the realisation of the cross-border right of establishment and freedom to provide services across borders for investment firms would have been illusory if the latter did not have the possibility to execute securities transactions on the financial markets of the host member state. Therefore, the right of access to the markets was considered an important ancillary right for an investment firm which had obtained a 'European passport' in its home member state. As a consequence, Member states would have to open their markets for foreign investment firms, without any possibility to impose upon them an additional authorisation requirement.

Conversely, the initial Commission proposal did not contain any provisions on the execution of transactions by investment firms, and more generally, on financial market structure: in the Commission's approach, investors and investment firms would be left free to bypass their domestic securities markets and direct transactions to other markets, whether stock exchanges or other organised or over-the-counter markets. It is not surprising that several member states expressed fierce opposition to this highly liberal proposal, which would put the stock exchanges and other markets under severe competition. The first official reaction came from the French government, which in December 1989 proposed to introduce in the directive a distinction between 'recognised' and 'over-the-counter' markets, where only the former were considered to offer sufficient guarantees to investors in terms of transparency, fairness and integrity.[9]

This intervention touched upon the fundamental issue of the impact of financial intermediary liberalisation on the international competition between securities markets. The concepts of 'concentration', 'transparency' and 'reporting' became critical in the negotiations on the draft ISD, and revealed the double dimension of the market competition issue: on the one hand, enhanced mobility of intermediaries would strengthen competition amongst the traditional stock exchanges. With the international liberalisation of capital movements and several other initiatives at EU level, this movement was already under way for some time, albeit at a relatively slow pace. The second, and much more important dimension, relates to the competition between traditional stock exchanges and new over-the-counter or less organised markets, which by their low degree of regulation and the use of modern screen-based trading platforms were driving away important trade volumes in equity from the domestic markets of the issuers. The success of the London based SEAQ-International was considered an important threat to domestic stock market liquidity by several continental European member states. This led to the formation of two groups of member states, representing diverging views and traditions with respect to stock market organisation when it came to discussing market structure related issues in the draft ISD. Both groups were designed with an acronym: one the one hand, the *Club Med countries* (France, Italy, Spain, Portugal, Greece and Belgium) advocated the maintenance and protection of centralised markets on which most transactions in financial instruments should be concentrated; on the other hand, the so-called *North Sea Alliance* (United Kingdom, Germany, the Netherlands, Luxembourg, Ireland, and Denmark) favoured a more liberal approach, according to which the choice for the optimal organisation structure of the market should be left to the markets

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8 See 7th recital, preamble ISD.

9 See also STEIL, B., "Equity Trading IV", in *The European Equity Markets. The State of the Union and an Agenda for the Millennium*, B. Steil (ed.), London, The Royal Institute of International Affairs and Copenhagen, European Capital Markets Institute, 1996, (113), p. 115-116.

themselves. Imposing strict rules on centralisation of equity transactions, though inspired by motives of market integrity and investor protection, would excessively impair on the principles of free movement of services and establishment for investment firms. The polarisation between the 'Club Med' and 'North Sea' member states could also be related to historically rooted disparities in market organisation, in particular the opposition between traditional order driven markets and the, mainly anglo-saxon inspired, concept of quote driven or dealership markets. In the end, the market organisation is related to the structure of domestic investment: order driven markets would be prominent in countries with a high quantity of small investors, while quote driven markets are more appropriate in absorbing liquidity provided by large institutional investors.[10]

The introduction of the concept of 'regulated market' in the directive, though related to issues of market integrity and transparency, has to be regarded against this background: the French and, to a less extent, German and Italian governments wished to consolidate trading on domestic markets and 'repatriate' stock trading on SEAQ-International to their domestic markets.[11]

3. Conduct of Business Rules for investment firms

Article 11 ISD enumerates a number of general principles relating to conduct of business rules to be observed by investment firms in carrying on their activities. The text substantially differs from the initial Commission proposals, and is the result of a compromise between the member states in the Council. Originally, the European Commission elaborated a detailed catalogue of conduct of business rules, inspired on the UK experience, and proposed to apply the home country and mutual recognition principles to the enactment and supervision of these rules by the member states. However, the first official draft directive submitted to the Council had already abandoned the mutual recognition approach: the Commission was sensitive to the fears expressed by several member states that applying the mutual recognition approach would enhance the delocalisation of investment activities to the least regulated market and in the end threaten overall market confidence. Instead, the draft directive allotted regulatory and supervisory powers with respect to conduct of business rules to the host country, as part of its powers under the general good. Moreover, the Commission draft did no more contain any provision on substantial harmonisation of conduct of business rules.

The final version of Article 11 ISD is a middle way between the two opposite approaches put forward by the European Commission: on the one hand, the directive contains a limited degree of substantial harmonisation of conduct of business rules, by enumerating a number of objectives which should be attained by the member states in implementing the directive into their national legal orders, but leaving them free to choose

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[10] About the differences between quote and order driven markets, see SCOTT-QUINN, B., "EC Securities Markets Regulations", in *International financial Market Regulation*, B. STEIL (ed.), Chichester, John Wiley, 1995, p. 141; GILLET, R., MINGUET, A., *Micro-structure et rénovation des marchés financiers*, Paris, PUF, 1995, p. 34-39; See for more details TISON, M., *De interne markt voor bank- en beleggingsdiensten*, Antwerp, Intersentia, no. 1649-1650, with further references.

[11] The latter consideration illustrates that the debates on centralisation of transactions in fact did not focus on issues of principle, but mainly on attempts by the Club Med countries to neutralise the success of SEAQ-International: see also WARREN, G.M., "The European Union's Investment Services Directive", *U. Pa. J. Int'l Bus. L.*, vol. 15, 1994, p. 211-212; BRADLEY, C., "The Market for Markets: Competition between Investment Exchanges", in *The Internationalisation of Capital Markets and the Regulatory Response*, J. FINGLETON, D. SCHOENMAKER (eds.), London, Graham & Trotman, 1992, p. 187.

the most appropriate means to ensure the effect of the directive.[12] On the other hand, the attribution of powers does not follow the home country paradigm: the competent member state in elaborating and supervising conduct of business rules is the state in which the services are provided. As the wording of several provisions of the ISD suggests, the attribution of powers shows analogies with the (host country) powers under the general good exception (see infra).

B. Minimum harmonisation

As is the case for the other internal market directives based on the 'new approach' adopted in the Commission's 1985 White Paper on the completion of the internal market, the ISD is based on a paradigm of 'minimum' harmonisation and mutual recognition between member states. Harmonisation is confined to setting the standards deemed necessary but sufficient to create a climate of mutual confidence between member states in which they are prepared to recognise the access to their markets of investment firms operating under the exclusive jurisdiction of their home state rules and supervision. As a consequence, the regulatory cost associated to the submission to multiple rules by internationally active undertakings is eliminated. The mutual recognition approach should furthermore foster market integration through regulatory competition without prejudice to the minimum standards imposed by the 'minimum' harmonisation.

The scope of minimum harmonisation as a corollary of mutual recognition of rules is limited: it covers mainly the authorisation requirements and prudential rules applicable to investment firms; as indicated above, the ISD also harmonises some aspects of the structure of organised financial markets, mainly in order to ensure the *effet utile* of the European passport for investment firms. Finally, the limited harmonisation of conduct of business rules does not follow the paradigm of 'minimum' harmonisation and mutual recognition.

1. Authorisation requirement for investment firms

As for credit institutions, the access to the market of an investment firm is subject to the granting of an authorisation (licence) by the competent authority of its home member state. An investment firm is defined as any legal entity which provides investment services for third parties on a professional basis. Investment services are the 'core' services listed in Section A of the Annex to the ISD, i.e. (1) the reception and transmission or the execution of orders in financial instruments on behalf of investors; (2) dealing for own account in financial instruments[13]; (3) individual discretionary portfolio management and (4) underwriting or placement of financial instruments. The financial instruments referred to are enumerated in section B to the Annex, and include all current instruments negotiated on equity, bond, money market and derivative markets. Commodities, precious metals and their derivative instruments do not qualify as financial instruments. Hence, the suppliers of

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[12] In fact, the drafting style of Article 11 ISD goes back to the very essence of a directive as legal instrument which only sets the objectives to be attained, leaving member states free as to the choice of means to reach this obligation as to a result: see the definition of a directive in Article 249 EC Treaty.

[13] According to the definition provided in Article 1.1 of the ISD, the dealing for own account in financial instruments will only qualify as investment service when provided 'for a third party'. The service essentially refers to market making activities, where the financial institution deals for own account as counterparty of investors, thereby contributing to shaping a market in certain financial instruments in a quote driven market: see also CARDON DE LICHTBUER, M., "Les perspectives européennes: le projet de directive sur les services d'investissement", in *Le nouveau droit des marchés financiers*, Centre JEAN RENAULD (ed.), Brussel, Larcier, 1992, p. 56-57.

investment services in these instruments do not qualify as investment firms, and are not subject to an authorisation requirement by virtue of the ISD. Conversely, these intermediaries cannot take advantage of the European passport provided for in the ISD, but can still rely on the Treaty freedoms when expanding their activities in other EU member states.

Given the broad definition of 'investment firm' as addressee of the authorisation requirement, it is not surprising that the directive contains numerous exceptions to its scope of application. Without entering into the details of the extensive list of exceptions in Article 2.2 ISD, it should be noted that several considerations lie at the basis of these exclusions:

- Non-application to otherwise regulated financial intermediaries: the directive does not apply to collective investment undertakings, whether or not of the UCITS type, and their depositories and managers; Neither are insurance undertakings subject to the provisions of the ISD when supplying investment services in the course of their business. Though subject to (prudential) supervision by virtue of other EU directives, the non-application of the ISD might make a difference as insurance undertakings are not necessarily bound by the conduct of business rules applicable to investment firms.
- Restricted scope or marginal importance of investment activities: the directive does not apply to the provision of investment services in an exclusive intra-group of companies context, or to undertakings for whom the investment activity is of relative unimportance to the main activity and subject to sufficient guarantees for the protection of investors (e.g. portfolio management by notaries);

- Investment activities with limited risks for investors: specific exemptions apply to specified activities which by their very nature do not expose client-investors to any substantial risk (e.g. mere transmission of orders to regulated financial institutions who guarantee the former's obligations);

- Public interest considerations: the conduct of member states' monetary policy and public debt management is partially insulated from the international liberalisation realised by the ISD: according to Article 2.4, the rights conferred by the ISD, i.e. the use of the European passport in cross-border business, does not apply to "the provision of services as counterparty to the State, the central bank or other Member State national bodies performing similar functions in the pursuit of the monetary, exchange-rate, public-debt and reserve management policies in the Member State concerned". Although this somewhat forgotten provision, as an exception to the general principles of the directive, should be interpreted restrictively, the importance of it may not be underestimated. In effect, it allows a member state to protect the local financial industry and set aside all foreign competitors in the choice of counterparties in open market monetary operations (e.g. swaps or repo-agreements) or in the primary public debt issues, selecting exclusively local firms as primary dealers in government securities. It is debatable whether the general nature of this exception is compatible with the EU Treaty. There undoubtedly are considerations of public interest involved when a member state is selecting its market counterparties in the conduct of its monetary and public debt policies. However, a less trade restrictive alternative to total exclusion from the benefit of the European passport could be to allow member states to impose additional (prudential) standards on a non-discriminatory basis to the financial institutions acting as their counterparties. Hence, it could be argued that the total exclusion constitutes a disproportional restriction to free movement of services and freedom of establishment. Furthermore, part of the exception may have become obsolete since the Europeanisation of monetary policy in stage three of monetary union. Finally, market forces and the competition between member states for public debt instruments in the eurozone will

probably foster a more liberal approach by member states in the choice of primary dealers in these markets. This voluntary liberalisation movement is already under way in different member states.

2. Prudential standards

The minimum harmonisation of prudential standards for investment firms in the ISD is to a great extent inspired by the similar provisions in the Second Banking Directive: the principles of adequate initial capital, sound administrative and accounting procedures, fit and proper control of board members and review of major shareholders are at present common features of prudential regulation of different actors in the financial world.[14] Only a few particularities with respect to investment firms will be briefly mentioned hereafter[15]:

- Legal form of the investment firm: contrary to the case of credit institutions, a member state can allow under national law that natural persons be authorised as investment firm.[16] The mutual recognition principle enables such investment firms to use their European passport even in member states which authorise only domestic investment firms organised as legal persons;
- Obligation to join an investment compensation scheme: each investment firm and credit institution offering brokerage, dealing of portfolio management services has to join an investment compensation scheme which conforms to the provisions of the directive on investor compensation schemes;
- Sound administrative structure and internal controls: the obligation to possess an adequate internal structure and organisation in view of the kind and size of proposed activity, must be assessed *in concreto* by the competent authority, and, according to the directive, take into account the control and safeguard measures for electronic data processing. The directive further adds that the internal control procedures should provide for particular rules on personal employee transactions.[17]

Article 10 ISD adds some specific prudential requirements to be met by investment firms in the exercise of their activities. Being of prudential nature, the home country principle equally applies to these rules:

- Segregation of client securities and money: investment firms should make adequate arrangements to segregate financial instruments and money belonging to clients from the firm's proper assets, such as to protect clients in case of insolvency and avoid use of client money and securities by the investment firm for own account. Given the very nature of the banking activity as deposit takers, the rules on segregation of client money do not apply to credit institutions.
- obligation to keep records of transactions for a period determined by the (home country) competent authority, in order to enable the latter to monitor compliance with the prudential rules applicable to the investment firm;
- be structured and organised in such a way as to minimise the risk of conflicts of interests with prejudicial effects for customers. This obligation is of prudential nature,

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14 The international acceptance of these standards has been further confirmed in the case of banking with the adoption, at the level of the Basle Banking Committee, of the *Core Principles for Effective Banking Supervision* in September 1997.

15 We will not deal with the EU provisions on initial capital and capital adequacy. See for more details: TISON, M., *De interne markt ..., op. cit.*, supra note 10, p. 805-812, No. 1595-1612, with further references.

16 This is for instance the case in the Netherlands (art. 14.2 Besluit Wet Toezicht Effectenverkeer) and in Luxembourg when the investment firm does not accept funds from clients (art. 16 Loi 5 avril 1993).

17 Art. 10, first indent ISD.

and calls for the necessary organisational measures to be taken (e.g. Chinese walls) by the investment firm. These 'organisational' arrangements have to be distinguished from the 'operational' rule on conflict of interest avoidance, contained in the catalogue of conduct of business rules in Article 11 ISD. The latter rules essentially refer to specific obligations arising when a conflict of interest can not be avoided through the normal organisational means, for instance because it arises within a single department of the firm. Usually, proper disclosure of the conflict or abstinence in executing the transaction with the client ('disclose or abstain') will ensure a fair treatment of the latter. The distinction between 'organisational' (Art. 10) and 'operational' (Art. 11) rules on conflict of interest avoidance in the directive is supplemented by a distinct attribution of powers: while the power to impose and supervise the 'organisational' rules is vested in the hands of the home country, as part of its overall prudential competence, the 'operational' conduct of business rule is of the competence of the member state where the investment service is provided, i.e. often the host state. Possible conflicts or inconsistencies between the requirements set by home and host state are in part resolved by the directive itself: if the organisational arrangement imposed by the home state on the foreign branch of a domestic investment firm is incompatible with the conduct of business rules applicable in the host state, the latter rule will prevail.[18] It may be submitted that in other cases the conflict will be solved in favour of the home country arrangements.

3. Market regulation

As already pointed out, the provisions on financial markets in the ISD are the result of difficult compromises between member states with highly divergent traditions of and views on financial market organisation. The central legal notion of the rules contained in the ISD is the "regulated market"(*infra*, a), which implies specific obligations with respect to reporting of transactions and the provision of information by the markets to investors (transparency) (*infra*, b). The organisation of a financial market as "regulated market" has important consequences for the possibility to direct financial transactions towards the markets ('concentration rule') (*infra*, c). More fundamentally, the ISD gives the regulated markets international recognition by providing on the one hand a right of access to investment firms with a European passport (*infra*, d), and allowing the markets to expand internationally to a certain degree (*infra*, e).

a. Notion of "regulated market"

The definition of a regulated market in Article 1.13 ISD is based on three objective criteria, referring to the regulatory and operational environment of the market. In particular, the market should:

- function regularly;
- be regulated with respect to conditions for operations on the market, the conditions for access by intermediaries to the market, and the conditions for negotiation of a financial instrument on the market. If the market provides for official listing of financial instruments, the listing rules must conform to the 1979 EEC directive on admission to listing.[19]
- comply with the rules on transparency and reporting of transactions, as laid down in Articles 20-21 ISD (see infra, b)

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[18] Art. 10, last indent *in fine* ISD.

[19] Council Directive 79/279/EEC of 5 March 1979 coordinating the conditions for the admission of securities to official stock exchange listing, OJ, L 66 of 16 March 1979, p. 21.

The directive does not further specify the contents of the first two criteria. It will be up to the home member state of the market (see infra) to assess whether these conditions are met before putting the market on its list of 'regulated markets'. Other member states will have to accept the qualification by the home member state of a market as 'regulated market', safe for the possibility to file a procedure before the Court of Justice when they are not satisfied with this decision.

To receive the qualification of 'regulated market', it is not sufficient to satisfy the aforementioned objective requirements. The market furthermore has to be put on the list of 'regulated markets' drawn up by the home member state of the market. This requirement adds a policy dimension to the objective criteria relating to the market organisation environment: the decision whether or not to put a market satisfying the objective criteria on the list of regulated markets lies with the home member state of the market and is of a political nature. Conversely, a market may only be added to the list once it satisfies to objective requirements imposed by Article 1.13 ISD. By adding a political criterion to the definition of a regulated market, the directive preserves in part a public policy approach in the organisation of financial markets by the member states: the ISD does not preclude the member states from continuing to exercise to a certain extent control over the domestic financial market landscape. Through the recognition of regulated markets, a member state has the possibility to preserve in fact the monopolistic position of existent markets, mainly stock exchanges, in a domestic context. Competing market structures could be refused the benefit of 'regulated market' status, which would clearly benefit to the regulated market in view of the application of the concentration rule.

The member state competent for granting the 'regulated market' status is the 'home member state' of the financial market, i.e. the state where the registered office of the body providing the trading facilities is situated, or if the body does not have a registered office under its national law, the member state in which that body's head office is situated (Art. 1.6(c) ISD). The definition of the market's home member state does not refer to the place where trading takes place. In view of the development of electronic markets deprived of any physical trading floor, the reference to the place of trading would have been inadequate. The main point of reference for determining the jurisdiction of a financial market indeed becomes the place from where the trading is organised (and supervised), referring to the centre of activities consisting of organising and managing the market. Several elements will be helpful in determining where the market is organised: the place of decision-taking with respect to admission to trade of financial instruments, admission of new members to the market, possibly the location of the computer servers enabling actual trading etc.. It is clear that the use of this criterion leaves room for 'forum shopping' and regulatory competition between member states for the attraction of new markets. The search for the optimal regulatory environment thus becomes an important element in setting up a new market.[20]

b. transparency and reporting

A regulated market should satisfy the requirements contained in Articles 20-21 ISD with respect to reporting of transactions to the supervisory authorities on the one hand, and the transparency of the market for the investors on the other. Though apparently quite technical, these rules were the subject of difficult discussions in the debate between *Club Med* and *North Sea alliance* member states. Both sides agreed that a market should be transparent in the sense that it generates in time all information needed for an investor to assess the state of the market. Indeed, greater transparency is viewed by most regulators as

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[20] See, for instance, the creation of EASDAQ, where Easdaq SA-NV incorporated under Belgian law as basis for its pan-European exchange.

an important element in ensuring market liquidity by reducing the opportunities for taking advantage of less informed market participants.[21] The critical discussions involved the issue of the time lag which could be left between the execution of transactions in a financial instrument negotiated on a regulated market and the public availability of that information. The proponents of quote driven markets wished to preserve a relatively high time interval, necessary to enable market makers to liquidate a position built up earlier, and to allow dealers to prepare reporting of transactions which are mostly concluded by telephone.[22] Closing the gap would create a disincentive to large block transactions and consequently drive away liquidity provided by large institutional investors.

The rules contained in the ISD are a compromise between both views on market transparency:

- investment firms must report to their home state competent authority all transactions in standardised financial instruments negotiated on a regulated market, whether or not they have been executed in the market. The time limit within which to effect the reporting is fixed by the competent authority, but may in no circumstance exceed the limit of the end of the next working day (Art. 20.1 (b) ISD). When transactions are executed on the market, the trading system of the market usually will be able to produce the information to be reported to the competent authority, which means that the investment firm will not have to file a separate report on these transactions.
- On basis of the information reported to it, each market authority should, for the regulated market it supervises, make available to investors information on market prices and trading volumes. The information flow is twofold (Art. 21.2 ISD):
  - information at the start of each trading day regarding the trading volumes and price evolution (highest and lowest price, average price) for the preceding day. This information will also include data on off-market transactions, if they have already been reported.
  - continuous information during the trading day about average prices and volumes of transactions effected on the market during the past hours: every 20 minutes, information relating to a two-hour trading period ending one hour before publication; and every hour, information relating to the six-hour trading period ending two hours before the publication. The provision enables market makers to liquidate positions they have built up in the course of the day during at least one or two hours before information on trading is available in the market. Moreover, the publication of information may be suspended or delayed in exceptional circumstances, or when it is not possible to preserve the anonymity of investors.

In sum, the rules on reporting and transparency to be applied in any regulated market take account of the functional specificities of both order and quote driven markets: on the one hand, the applicable rules make sure that relevant information on both on and off-exchange transactions are reported to market authorities and made public. On the other hand, the time lag between reporting and publication of information allows the markets to absorb fluctuations in the transaction volume without the risk of unjustified market disturbances. For transactions effected on the market, the limited delay in publication of data on transaction volumes and prices will enable investors to have a 'true and fair view' of the state of the market.

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[21] FERRARINI, G., "The European Regulation of Stock Exchanges: New Perspectives", *CMLR*, 1999, (569), p. 579, with further references.

[22] See for the latter: PAGANO, M., ROËLL, A., "Transparency and Liquidity: A Comparison of Auction and Dealer Markets with Informed Trading", *J. Fin.*, 1996, p. 580, cited in FERRARINI, G., *op. cit.*, *supra* note 21, p. 578-579.

It seems that most member states have not experienced major difficulties in implementing the rules on reporting and transparency for their regulated markets. In fact, the result of the ISD rules has been to stimulate more timely dissemination of trade information, even in the member states which opposed the strict rules on transparency. In the UK, the London Stock Exchange has agreed to increase the volume of immediate post-trade publication, the result of which being that 75% of domestic equity trading is reported and published immediately.[23] Only Greece indicated that the electronic trading system of the Athens Stock Exchange did not make it possible to publish information on average and highest and lowest prices in the market every 20 minutes. The Greek government considers that investors are sufficiently informed when the system allows them to see the prices of shares in reasonable time. As no other member states have reported similar difficulties, the European Commission considers that no amendments to the ISD are necessary with respect to reporting and transparency.[24]

c. Concentration rule

The concentration or centralisation rule refers to the possibility for a member state to require financial transactions to be executed on a regulated market, thereby ensuring a certain centralisation of transactions and liquidity of the market. As indicated above, the effect of the rule obviously is to protect regulated markets against competition from non-regulated exchanges or off-market transactions. However, by formulating the rule as optional for member states, and enabling investors to waive the centralisation requirement, the anti-competitive effect of the concentration rule could well be less important than many have feared.

The conditions under which a member state can require centralisation of transactions are formulated in a way as not to obstruct the use by investment firms of their European passport and to preserve the free movement of capital through investment in financial instruments. Article 14.3 ISD allows centralisation of transactions when three conditions are met:

- the investor has its habitual residence or is established in the member state imposing the concentration requirement;
- the investment firm carries out transactions in financial instruments in the member state through a main establishment are with use of its European passport (branch or free provision of services). In other words, the concentration rule may not be an alibi for protecting domestic investment firms against foreign competitors;
- the transaction must involve a financial instrument dealt with on a regulated market in the member state imposing the centralisation.

When these conditions are satisfied, the member state in question may require execution of the transaction on *a* regulated market, either the domestic market or a regulated market situated in another member state where the same financial instrument is negotiated.[25] Prohibiting the execution on a foreign regulated market in another member state[26] would amount to a disproportional restriction on capital movements. In reality, the limited multiple listing of financial instruments on several exchanges until now results in fact in a

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23 See FERRARINI, G., *op. cit.*, *supra* note 21, p. 580-581.

24 See EUROPEAN COMMISSION, *Investment Services Directive. Commission report on the operation of certain articles in the directive*, COM(1998) 780 final, 21 December 1998.

25 FERRARINI, G., *op. cit.*, *supra* note 21, p. 584-585.

26 The concentration rule will not be complied with when the transaction has been executed on a market in a third country (e.g. execution on Nasdaq of a transaction in a financial instrument negotiated on Easdaq).

strong protective effect of the concentration rule, as no alternative is available for investors on other regulated markets.

When a member state imposes a concentration requirement, it should also provide for a derogation to it: investors must have the opportunity to waive the concentration and to have transactions executed off-market. The conditions under which a waiver may apply, must take account of the investors' differing needs for protection, and in particular the ability of professional and institutional investors to act in their own best interest. In practice, non-professional investors will often be required to give their individual and express written consent for off-market execution of each transaction, while professional investors will be allowed to grant a general authorisation which is not subject to any formal requirements.[27]

It is interesting to note that at least five member states (Austria, Denmark, the Netherlands, Portugal and Sweden) decided not to impose any concentration requirement as far as their regulated markets are concerned. This would indicate that for these member states at least the discussion on concentration is irrelevant or obsolete: in terms of policy, they prefer to leave the determination of the optimal way of executing transactions to the investors.

It is debatable whether the concentration rule under its present appearance in the ISD is fully compatible with the EU Treaty, notably the rules on competition. In fact, the ISD allows member states to restrict to a large extent off-exchange transactions by imposing strict conditions on their validity, which could act as a serious deterrent. In view of the reality of relatively few multiple listings of financial instruments, the provision furthermore restricts inter-exchange competition. In a domestic context, inter-exchange competition could be further restricted through the state prerogative to decide which exchanges qualify as 'regulated market'. In certain circumstances, the overall result could be that the member state is found to impose or favour abuses of dominant positions by their stock exchanges or other regulated markets.[28]

d. Access to regulated markets by investment firms and credit institutions

As corollary of the European passport, investment firms and credit institutions offering investment services have a right of access to or membership of the regulated markets in other member states. This right of access[29] may not be underestimated: it not only enhances competition on these markets between domestic and foreign investment firms, which should improve the quality of the services provided and create a downward pressure on transaction costs. The access to the market also enhances competition between (regulated) markets: for financial instruments negotiated on different markets, the investment firm will choose the market which offers the lowest transaction costs and highest security. Investment firms will moreover be able to diversify their product ranges by offering to their customers financial instruments exclusively negotiated on foreign regulated markets. This aspect of enhanced competition between markets will in turn stimulate diversification and financial innovation by the markets.

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27 See e.g. under Belgian law Royal Decree 19 May 1996.

28 Compare FERRARINI, G., *op. cit.*, *supra* note 21, p. 585-587, who compares concentration requirements in an antitrust perspective to vertical restrictions under the form of exclusive dealing between a producer and distributors to limit their clients' free riding.

29 Hereafter understood as including both the right of access *stricto sensu*, i.e. the right to execute transactions on the market and to participate in the clearing and settlement mechanisms, and the right to become member of the market, i.e. participating in the decision-making bodies (usually the general meeting of shareholders) of the entity which organises the market.

It is not clear whether the right of access to or membership of a regulated market exists in itself, or whether it has to be viewed as a necessary consequence of the use of the single passport in the host country by an investment firm. The latter interpretation would mean that an investment firm should necessarily provide investment services to investors in the host country in order to gain access to the regulated market. The former interpretation is broader: the right of access to the market in a host state could exists even without a client base in that country, but could be used for the benefit of investors in the home country or another member state. Though the restrictive interpretation is more in line with the wording of the directive, the general objectives of the directive seem to dictate the broader interpretation. This approach would have the additional advantage of avoiding discussions on determining when an investment service is provided in the host state.

The right of access imposed by the ISD puts far reaching organisational and technical constraints on the regulated markets, as the directive prescribes the abolishment of all quantitative restrictions on the access to the market by investment firms and credit institutions. When such limitation derives from its legal structure (e.g. non public company) or from the technical capacity of the market in question, the member state should ensure that the market structure and capacity is regularly adjusted.[30] These requirements have been rightly criticised as expressing an obsolete view on a 'public utilities' approach of regulated markets. With the 'privatisation' of markets as business entities which are providers of trading services, the issue of access and possible exclusions of investment firms could better be assessed against the background of the competition provisions of the Treaty.[31]

The right of access to the regulated market can take different forms:

(a) direct access, through a branch in the host state;
(b) indirect access, by setting up a subsidiary or acquiring an existing member of the market in the host state, or
(c) remote access, without any physical presence in the host state.

The directive does not strongly interfere in the organisation of the regulated markets by the member states: the host state is free to determine whether access to the market requires a physical presence on its territory, in which case the investment firm should have the choice between direct and indirect access. The continuous technological developments will probably further reduce the importance of physical presence of traders on the exchange floors, and gradually replace it by remote access to the markets through screen trading.

The principle of mutual recognition will only have a limited scope in the context of access to regulated markets: host member states are entitled to impose additional capital requirements for matters not covered by the Capital Adequacy Directive, for which mutual recognition applies.[32] In reality, it does not seem that investment firms have been subjected

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[30] Article 15.1 ISD.

[31] FERRARINI, G., *op. cit.*, supra note 21, p. 589-590.

[32] Art. 15.2 ISD recalls, with respect to access to regulated markets, that this right of access is conditional upon compliance with the home state rules on capital adequacy. This might seem surprising, as this already follows from the very principles of mutual recognition and home country control. Formulating again this requirement could be interpreted as granting to the host state (market) authorities the right to exercise control over compliance with the home state rules, and possibly refuse or revoke the access to the regulated market in case of non-compliance. This conclusion would contrast with the current case law of the Court of Justice, which would not grant any right to the host state to unilaterally revoke the benefit of the European passport to a foreign undertaking when the home country rules are not complied with.

to additional capital requirements in the context of access to regulated markets in other member states.

In addition, investment firms seeking access to a regulated market in the host country will have to conform to the local rules on market organisation and functioning, such as conditions for membership, rules on trading hours, professional codes for traders etc. The rules on market organisation and supervision may however not interfere with the prudential rules applicable to the investment firm, *inter alia* on internal organisation of the firm, for which the home country principle continues to fully apply.

e. Internationalisation of regulated markets and mutual recognition

When access to the regulated market does not require any physical presence in the host state, investment firms may have access to the market on a remote basis. To this end, art. 15.4 ISD stipulates that the home member state of these investment firms should allow the host state's regulated market to provide appropriate facilities within its territory, notably through the installation and connection of trading screens.[33] In legal terms, this right for the regulated market to provide facilities in other member states is an expression of the right of free provision of services by the market in other member states.[34] Some even speak of a 'European passport' for regulated markets.

In fact, the possibility of out-of-state activity by the regulated markets through screen trading points to a much more fundamental evolution in the design and operation of financial markets: the market ever more becomes a business unit which by its essence is a service provider in relation to financial intermediaries by offering a trading platform and related services of clearing and settlement of transactions in financial instruments. In this emerging pattern of financial markets, the market itself as business enterprise should be allowed to diversify its activities across borders, by exercising the fundamental rights of free movement guaranteed by the EU-Treaty. It should be noted that the ISD only constitutes a minor, and most probably not deliberate, move in this direction: only for regulated markets does the directive provide for a limited right to deploy activities in another member state, notably by prohibiting other member states from obstructing the trading screen connection between the market and investment firms in these states.

The inclusion of a uniform definition of a 'regulated market' in the ISD, and the obligation for member states to mutually recognise the qualification of 'regulated market' given by the home state of the market[35], shows the potentialities for further internationalisation of regulated markets in the perspective of ongoing liberalisation of capital markets within the EU. For instance, regulated markets could well in the future invoke the Treaty freedom of establishment in order to create branches in other member states which offer their trading facilities through a permanent presence, under the label of 'regulated market' given by the home state of the market. At least for regulated markets,

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33 Some problems were reported in the past with respect to cross-border connection of screens, in particular when *Deutsche Börse* was refused authorisation to place screens in some member states: SEIP, S., "Implementation of the ISD: Major effects on Deutsche Börse AG, its market participants and consequences to the German regulatory environment", in *Conference: Investment Services Directive*, Brussels, MGI, 12 October 1995, p. 7-8.

34 Compare LEE, R., *What is an Exchange? The Automation, Management, and Regulation of Financial Markets*, Oxford, Oxford University Press, 1998, 137; STEIL, B., *op. cit.*, supra note 9, p. 129; FERRARINI, G, *op. cit.*, supra note 21, p. 587;

35 This appears most clearly in the concentration rule, according to which a member state should consider execution of transactions on the regulated market of another member state as equivalent to execution on a domestic regulated market where the same financial instrument is negotiated.

there does not seem to be any reason to obstruct the activity of the market in other member states in the interest of the general good. The implications of these evolutions for the exercise of supervision by the market authorities are still unclear: in an internal market perspective, home country control should logically be introduced in market supervision. In fact, home country control already applies for market supervision in case of remote access by investment firms, even if the latter do not have any physical presence in the home state of the regulated market.

4. Transactional regulation: advertisement and conduct of business rules

As was the case for credit institutions under the Second Banking Directive, the harmonisation realised by the ISD mainly touches upon rules on the taking up of business in other member states, but leaves the conditions of exercise of the activity largely untouched. In the context of the ISD, the general harmonisation of conduct of business rules attenuates this principle. As indicated above, the compromise reached at EU level resulted in formulating only general objectives to which the elaboration of conduct of business rules should conform, and leaving the path of home country control for allocation of regulatory and supervisory powers to the benefit of the member state where the service is provided.

The determination of the member state where the investment service is provided as competent member state for imposing the conduct of business rules has emerged as a major interpretation issue in the application of the ISD. Initially, most commentators of the directive interpreted Article 11 as attributing competence to the host country, i.e. the country of residence of the client to whom the investment service is provided. More recently, this interpretation has been rejected as over-simplifying the reality of international transactions.[36] In reality, more than one member state could legitimately claim competence for applying its conduct of business rules in view of the connection of a transaction with its jurisdiction. The classical example is the execution of a transaction in financial instruments by an investment firm authorised in member state A for a customer with residence in member state B and to be executed on a (regulated) market in member state C. All three member states could claim to be a member state where the investment service is provided, depending on the criteria to be used to localise the place of service supply: the head office of the investment firm, the place of residence of the client or the market in which the transaction is executed. The possibility of divergent of even conflicting conduct of business rules in a cross-border context and the legal uncertainty about which conduct of business rules to apply, are likely to discourage the use of the European passport by investment firms.

A possible solution to this interpretation issue rests in our view on a double assumption: first, Article 11 ISD does not necessarily point to one single member state as being the member state where an investment service is provided: when significant connections exist with several member states, as in the example given above, it is not contrary to the wording of Article 11 ISD to attribute competence to different member states. Second, the attribution of powers in the ISD must be read in conjunction with the overriding Treaty freedoms: the interpretation of Article 11 ISD may not lead to a situation of unjustified restriction on free movement of services. Therefore, it has been rightly suggested to apply the general good-test to the attribution of powers resulting from Article 11 ISD.[37] The result of both assumptions is the following: where the home member state

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[36] See *inter alia* DAX, D., "L'impact de la communication interprétative pour le secteur des services d'investissement", *Bulletin Droit & Banque*, No 28, June 1999, p. 10-11.

[37] See also CRUICKSHANK, C., "The Investment Services Directive", in *Further Perspectives in Financial Integration in Europe*, E. WYMEERSCH (ed.), Berlin, De Gruyter, 1994, p. 73 WOUTERS, J., "Rules of Conduct, foreign investment firms and the ECJ's case-law on services", *Comp. Lawy.*, 1993, p. 195; LASTENOUSE, P., "Les règles de conduite et la reconnaissance mutuelle dans la

applies its conduct of business rules to a cross border transaction by an investment firm under its supervision, other member states where the investment service is provided will be able to exercise their competence in the field of conduct of business rules only when the restriction on free movement resulting from it is justified in the interest of the general good and satisfies the proportionality test. The latter member state will have to demonstrate that the conduct of business rules of the home state do not, in its view, sufficiently protect the investors or the market. Within the scope of the conduct of business rules harmonised through Article 11 ISD, it may be submitted that the general good-test will not be easily satisfied, as all member states are considered to apply conduct of business rules which properly attain the objectives enumerated in the catalogue of Article 11. Nevertheless, it would be too restrictive to consider that Article 11 ISD totally excludes the application of the general good test and virtually leads to application of the home country rule. The community legislator clearly did not intend to apply the home country rule in the field of conduct of business to the same extent as for prudential regulation of investment firms.

As in the Second Banking Directive, the ISD guarantees the right for an investment firm to advertise its services in other member states, subject to application of the general good rules of the host state. The provision mainly is of declaratory nature, as the application of the Treaty principle of free movement of services would lead to the formulation of a similar rule: the investment firm has the right to advertise its services, according to the rules applicable in its home state. The host state is only entitled to impose additional or different requirements, which by assumption restrict free movement, when all conditions of the general good test are satisfied. In one respect does the ISD further clarify the general good-test with respect to advertisement: the ISD now contains a fundamental right to advertise services, which means that the host state could never impose a total ban on advertisement for reasons of general good.

C. Mutual recognition

1. Origin of the mutual recognition principle

The concept of the European passport for investment firms is based on the legal principle of mutual recognition: the host member state must recognise the regulation of and supervision on investment firms in their home member state as equivalent to the supervision exercised in the host state. Consequently, the host state cannot regulate the activities of investment firms licensed in another EU member state within the scope of mutual recognition and home country control.

It is well known that the mutual recognition principle finds its roots in the case law of the Court of Justice as it first appeared in the *Dassonville* and *Cassis de Dijon* cases in the area of free movement of goods. In essence, the general prohibition of non-discriminatory restrictions to free trade could be translated into a principle of mutual recognition: a good legally manufactured and distributed in its home member state should be allowed to be

directive sur les services d'investissement", *R.M.U.E.*, 1995/4, p. 101-102 THEIL, L.R., "The EC Investment Services directive: a critical time for Investment Firms", *JIBFL*, 1994, p. 64; ALCOCK, A., "UK implementation of European Investment Services Directives", *Comp. Lawy.*, vol. 15, 1994, p. 299 WYMEERSCH, E., "Les règles de conduite relatives aux opérations sur instruments financiers", *Rev. Banque*, 1995/10, p. 591 O'NEILL, N., "The Investment services Directive", in *The Single Market and the Law of Banking*, R. CRANSTON (ed.), 2nd ed., London, LLP, 1995, p. 201-202; LOUIS, P.-M., “Le concept de passeport européen dans la directive 93/22/CEE du Conseil, du 10 mai 1993, concernant les services d’investissement dans le domaine des valeurs mobilières”, in *De hervorming van de financiële markten en bemiddelaars*, Cahiers AEDBF/EVBFR-Belgium, No 5, Brussels, Bruylant, 1997, p. 57, no. 74.

distributed in other member states under the same conditions. The host state could only impose own additional or divergent product or marketing rules, which by hypothesis constitute a restriction to free movement, when these rules are justified by an overriding motive of public interest (general good). The Court's case law on goods has since the beginning of the 1990s been gradually extended to the area of services and, more recently, to the right of establishment. Since the *Gebhard* case[38] it is commonly accepted that the prohibition of all restrictions, whether discriminatory or not, is common to the interpretation of all Treaty freedoms. The *Cassis de Dijon*-principle, resulting in the formulation of a principle of mutual recognition, equally applies in the area of services and establishment.

2. Interrelation between the ISD and the Treaty: 'perfect' and 'imperfect' mutual recognition

In its evolution over the past years, the Court's case law on services and establishment has in part bridged the gap with the mutual recognition principle enshrined in the ISD and similar internal market directives, though the latter principle was advanced in the mid '80s by the European Commission as an almost miraculous remedy to achieving the internal market without full harmonisation of laws. This is not to say, however, that the directives have become obsolete in formulating the mutual recognition principle. In fact, the legal effects of mutual recognition still substantially differ depending on its origin in the Treaty or in the internal market directives. Indeed, the mutual recognition deriving from the Treaty freedoms lacks the absolute and unconditional character of the same principle contained in the directives: under the Treaty, mutual recognition may be tempered by the general good exception, which enables the host state to impose its rules which are justified by an interest overriding the imperatives of free movement. Mutual recognition in essence has a negative connotation: it prohibits the host member state from applying its own — hypothetically restrictive — rules on a foreign entrant, unless it is demonstrated that the general good test is satisfied. Mutual recognition may against this background be qualified as 'imperfect'. By contrast, the mutual recognition principle contained in the internal markets, and intimately associated with 'minimum harmonisation' is mandatory and absolute. Due to the minimum but sufficient harmonisation, which in the view of the Community legislator constitutes the codification of the general good, member states are no longer allowed to invoke the general good to legitimate application of their own stricter rules to foreign entrants. The attribution of regulatory and supervisory powers to the home state is absolute and exclusive, unless otherwise provided in the directive, and may lead to extra-territorial exercise of its sovereignty (e.g. possibility for on site examinations with out-of-state branches). In its absolute appearance, mutual recognition results in formulating a conflict of laws rule: the cross-border activity of an investment firm under the European passport regime, is governed by the law of the home country with respect to the formulation of authorisation requirements and prudential standards. The mutual recognition principle may therefore be qualified as 'perfect'.

In view of the above considerations, it is still necessary to delimit the scope of 'perfect' and 'imperfect' mutual recognition when it comes to determining the respective powers of home and host member states in the regulation of investment firms and investment activities. In addition, when the directives contain exceptions to mutual recognition, their compatibility with the Treaty freedoms should be examined, more precisely to determine whether the exception can be brought under the heading of the general good exception.

3. Scope of the 'perfect' mutual recognition principle in the ISD

[38] ECJ, judgement of 30 November 1995, *Gebhard*, case C-55/94, E.C.R., 1995, I-4165.

Applied to the ISD, we may summarise the respective scope of perfect and imperfect mutual recognition as follows:

With respect to the *regulation of investment firms*, 'perfect' mutual recognition applies first of all to the access to the activity, i.e. the principle of an authorisation to carry on activities and the conditions attached to it. This constitutes the core of the European passport: the host member state may by no means restrict the absolute right of the home state authorised investment firm to start supplying investment services through a branch or directly, after having if necessary satisfied the notification procedures laid down in Articles 17 or 18 ISD. Neither could the host state interfere in the choice between branch activity or direct provision of services in the use of the European passport by a foreign investment firm, for instance by imposing conditions on establishment or permanent presence in the host state for the exercise of certain activities. This choice should be left over exclusively to the investment firm. For instance, a member state cannot require that the underwriting of a securities issue in the domestic market should be effected by an investment firm (or credit institution) established in that member state. The directive itself contains however a limited exception to this principle in the context of access to regulated markets in the host state: when remote access is not possible, the host state may require the investment firm to seek access through a permanent establishment, either a branch or a subsidiary. Such requirement of establishment does not preclude the investment firm from being active in the host country through direct supply of services, for instance in accepting orders in financial instruments. The intervention of the host state establishment will only be required for the execution of such orders on the host state regulated market.

Second, 'perfect' mutual recognition is imposed by the ISD in the field of prudential regulation and supervision, i.e. the formulation of both initial and ongoing prudential standards. In these areas, the home state has exclusive competence, even for aspects of regulation and supervision which have not been specifically harmonised. This may lead to interpretation questions as to what exactly constitutes 'prudential' regulation for which the host state lacks any competence. In general terms, it refers to all conditions relating to the internal structure, internal organisation and overall financial situation of the firm. Contrary to the Second Banking Directive, no exception to mutual recognition exists with respect to liquidity supervision of branches[39], since investment firms are not exposed to the same kind of liquidity risks as deposit taking institutions.[40]

The operational rules on the provision of investment services (e.g. advertisement, commercial practices, conduct of business rules, mandatory contract rules etc.) remain outside the scope of 'perfect' mutual recognition. As already indicated, the ISD confirms the application of the Treaty freedoms with respect to advertisement. It is clear that the principles of free movement equally apply to other commercial practices or mandatory contract rules in the conduct of investment business: an investment firm may rely on its home state rules when supplying services in the host state, but the latter is allowed to impose its stricter or divergent rules when the restrictions to free movement resulting from them are justified by the general good. It has been argued above that, notwithstanding the wording of Article 11 ISD, the same principles will apply with respect to conduct of business rules: the attribution of competence to the member state where the investment service is provided must be read in conformity with the Treaty, i.e. when exercise of the competence restricts free movement as it requires an investment firm to operate under

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[39] Art. 14 Second Banking Directive.

[40] In addition, the liquidity supervision exception for credit institutions is closely related to monetary supervision, which also remained under host country supervision. Since the activities of investment firms do not have direct effects on the money supply, there is no need to provide for separate liquidity and monetary supervision.

stricter or more burdensome rules of conduct, the application of the latter should satisfy the general good-test.

The regulatory environment of *access to regulated markets* by an investment firm in the host member state is not covered by the principle of 'perfect' mutual recognition: The host state is entitled to impose its own rules on market access and organisation, as long as they do not interfere with or impose additional prudential requirements for which only the home state authorities are competent. For instance, the market authorities are not allowed to regulate the internal organisation of a foreign investment firm for the purpose of avoiding conflicts of interest. One single exception, provided in the directive itself, concerns the possibility for the host state to impose additional capital requirements for matters which have not already been harmonised (e.g. capital rules in the context of participation in the clearing and settlement system of the host state regulated market). Of course, the host state should comply with the Treaty freedoms in applying its conditions on access to regulated markets and rules on market organisation and functioning. This means that the rules applied to the foreign investment firm should first be non-discriminatory, and when they nevertheless constitute a restriction to free movement, be justified by the general good. Given the limited degree of harmonisation of market organisation rules, and the legitimated general good interest associated with rules on market integrity and preservation of investor confidence, the application of the general good test should not create major difficulties in this area of regulation for the host states.

Finally, the ISD attaches mutual recognition to the *status of regulated market* in a member state: when a member state puts a market for which it is the home state on the list of 'regulated markets', this qualification should be recognised as such by the other member states. This recognition serves a double purpose: First, the regulated market will have the right to offer its trading services in other member states by ensuring the connection of investment firms to the market through remote access. Second, a member state must accept execution of a transaction on a regulated market of another member state as equivalent to execution on its domestic regulated market for the purpose of satisfying the concentration requirement which may apply in the former state.

4. Mutual recognition and deficient home state supervision

The absolute character of 'perfect' mutual recognition in the context of the ISD raises the question as to which remedies exist for the host member state when the home state allegedly does not properly regulate and supervise investment firms which make use of their European passport in the host state.

First, it should be noted that the provisions of the ISD, in particular Article 19 on supervisory co-operation, do not offer a legal basis for the host state authorities to intervene in such a situation. The possibility for the host state competent authorities to intervene in situations where the foreign investment firm is in breach of host state rules (Art. 19.3 to 19.5) or to take emergency measures under very strict conditions (Art. 19.8) cannot be invoked to remedy insufficient regulation or supervision by the home state in general. Indeed, the powers conferred upon the host state competent authorities under these provisions do only apply when the investment firm "is in breach of the legal or regulatory provisions adopted in that State pursuant to those provisions of this Directive which confer powers on the host member state's competent authorities". The reference to the powers conferred by the ISD itself to the host state's *competent authorities*, i.e. the authorities designated under Article 22 ISD to supervise investment firms or responsible for market

supervision[41], substantially restricts the scope of these provisions. Indeed, in the area of prudential supervision, the ISD does not contain any exception to the principle of home country control and concurrent attribution of powers to the host state competent authorities, in contrast to the case of branch liquidity supervision under the Second Banking Directive.[42] In fact, only Article 19.1 stipulates an explicit competence of the host state competent authority, namely for the purpose of collection of statistical information from investment firms. Logically, the scope of the intervention powers under Articles 19.3 to 19.5 and 19.8 ISD should be confined to non-respect of the powers under Article 19.1, and may therefore not be invoked to interfere in the system of home country control.

More fundamentally, the host state could justify a possible intervention under the motive that the investment firm does not satisfy the material conditions for mutual recognition, notably the conformity with the harmonised prudential standards which are deemed 'necessary' to obtain the benefit of the European passport. Recent case law of the European Court of Justice and of national courts clearly rejects this line of reasoning: the host state is not allowed to unilaterally restrict or revoke the benefit of the single licence if the supervision exercised by the home country allegedly would be insufficient, or if the authorisation granted to the investment firm in its home country would not be in conformity with the prudential standards imposed by the EU directives. The same principle will apply when a member state puts a market on the list of 'regulated markets' while the latter allegedly does not satisfy the objective criteria imposed by the ISD.

Illustrative in this context is a judgement of the Belgian *Conseil d'Etat* with respect to the cross-border distribution of units in a collective investment undertaking.[43] The plaintiff, *Fleming Flagship Fund*, was a Luxembourg based collective investment undertaking (UCITS), authorised under Luxembourg law, and benefiting from a European passport under the 1985 UCITS-directive. When applying for distribution of the units relating to a specific compartment in Belgium with use of its European passport, the Belgian Banking and Finance Commission refused to grant authorisation, under the motive that *Fleming Flagship Fund* did not abide by all provisions of the UCITS directive, despite the authorisation granted by the Luxembourg competent authority. Upon appeal, the Belgian Ministry of Finance confirmed the refusal: host state authorities are entitled to refuse the benefit of the European passport to a financial institution authorised in another EU member state, which does not conform to the substantive rules of the applicable directives which constitute the precondition for the right to rely on mutual recognition of home state authorisation and supervision. The action in annulment against these decisions brought by *Fleming Flagship Fund* before the *Conseil d'Etat* succeeded. Relying mainly on the text of the UCITS directive and the Belgian implementing legislation, the *Conseil d'Etat* held that the host state should exclusively make use of the mechanisms provided for in the EU Treaty and the relevant directives when the home country allegedly does not properly authorise or supervise the financial institutions falling under its jurisdiction. Surprisingly, the *Conseil d'Etat* did not deem it necessary to refer a preliminary question on the interpretation of the EU Treaty or the UCITS directive to the Court of Justice. It may however be submitted that the solution adopted by the *Conseil d'Etat* is in line with recent case law of the Court of Justice on the application of the Television Directive[44], and that the same principles will apply with respect to the system of mutual recognition under the Investment Services Directive.

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[41] See also BIANCHERI, C. "The Co-operation among Supervisory Authorities under the Investment Services Directive", in *European Securities Markets*, G. FERRARINI (ed.), Kluwer, 1998, p. 367.

[42] Consequently, the analogous provisions in the Second Banking Directive (Articles 21.3 to 21.5 and 21.8) should be interpreted as conferring intervention powers upon the host state prudential authorities solely within the context of branch liquidity supervision. See in more detail: TISON, M., *De interne markt...*, op. *cit.*, supra note 10, p. 676-682, para 1326-1337

[43] Conseil d'Etat, 4 June 1997, *Rev. Banque*, 1997, p. 588, note M. TISON, *Bulletin Droit & Banque*, 1998, No 27, p. 37, note J.P. BUYLE.

[44] See, *inter alia*, ECJ, 10 September 1996, *Commission v. Belgium*, case C-11/95, E.C.R., 1996, p. I-4115; ECJ, 29 May 1997, *Denuit*, case C-14/96, E.C.R., 1997, p. I-2785; compare also in general on the prohibition of unilateral remedy by a member state: ECJ, 13 November 1964, *Commission*

In the event of alleged insufficient home country supervision over the banking activities conducted in the host country, the latter would only be entitled to file a complaint with the European Commission or bring an action against the home state before the Court of Justice (Articles 226 and 227 EU-Treaty). In case of emergency, the host state could ask the Court to revoke the single licence by way of interim measure (art. 241 EU Treaty). This case law strongly relies on the assumption that in a system of economic integration the member states should as a rule have full mutual confidence in the quality of each other's supervision.

Part II. - Implementation of the ISD in the EU Member States

The implementation of the ISD was, more than was the case for the Second Banking Directive, seen as an opportunity to conduct more fundamental reforms of supervisory structures of both the markets and the market intermediaries in most EU member states. The ISD, and the international competition between financial markets and exchanges it induces, has also been seen as an opportunity to reform the organisational patterns of the financial markets themselves: organisational and technological modernisation, demutualisation of stock exchange ownership and cross border alliances are high priorities for all European exchanges today. The regulatory reforms under way in many EU Member States witness this new climate of market openness, 'privatisation' of exchanges and enhanced inter-exchange competition.

It is not possible to provide an exhaustive overview of the implementation process in the different Member States.[45] We will limit ourselves to sketching the main tendencies in this process, as exemplified by the "post-ISD" situation in a limited number of member states (Belgium, France, Germany, Luxembourg, the Netherlands and the United Kingdom).

A. General Remarks

Article 31 ISD provides that member states had to adopt the legal and regulatory provisions needed to implement the directive before 30 June 1995, while the actual entry into force of these provisions could not be set later than 1 January 1996. The two-stage implementation calendar allowed the Commission to prompt member states to take necessary action even before the directive actually entered into force. In general, most EU member states did implement the ISD more or less in time. However, both Luxembourg and Spain suffered serious delays in implementing the directive, which led the Commission to bring an action against both member states before the Court of Justice. By judgement of 3 June 1999, the Court held Luxembourg in breach of its obligations under Community law.[46]

The late implementation in some member states did not seem to hamper the use by foreign investment firms of their European passport in these countries, as the direct effect of the directive could be invoked against the authorities of the latter. The administrative

v. Luxembourg and Belgium, E.C.R., 1964, p. 1277; ECJ, 25 September 1979, *Commission v. France*, E.C.R., 1979, p. 2729; ECJ, 23 May 1996, *Hedley Lomas*, E.C.R., 1996, p. I-2553.

[45] See for a more complete overview WYMEERSCH, E., "The Implementation of the ISD and CAD in National Legal Systems", in *European Securities Markets* G. Ferrarini (ed.), London, Kluwer, 1998, p. 3-44.

[46] Case C-417/97, *Commission v. Luxembourg*, judgement of 3 June 1999, not yet reported in E.C.R.

practice of the supervisory authorities seemed to be established in the sense of allowing the use of the single passport even in the absence of implementation of the ISD.

A first common feature of implementation in the member states relates to the amount of regulation induced by the ISD: regulating the status of and supervision on investment firms on the one hand, and introducing new rules on market organisation and supervision has led to massive re-regulation, in which the general legal framework often had to be complemented by numerous detailed regulations. In Belgium, the general frame, contained in the Law of 6 April 1995, has been further implemented through not less than fifteen royal and ministerial decrees, including for instance the approval of the market rules of the different regulated markets.[47] A similar pattern is found in France: the general framework for implementation is enacted in a "Loi de modernisation des activités financières", while further details are promulgated by decrees. Likewise, the "Wet Toezicht Effectenverkeer" constitutes the core of the Dutch implementation, with more precise rules in decrees and delegated regulation by the competent minister. In Germany, the implementation process of the ISD focused mainly on financial market reform, which was already under way for some years. The Second financial market reform act (2. Finanzmarktförderungsgesetz or Wertpapierhandelsgesetz) of 1994, reorganised the financial market design and supervisory structure, by introducing a supervisory body at federal level (the Bundesaufsichtsamt für den Wertpapierhandel - BaWe). The law further contained a few anticipated implementation measures of the ISD, such as the conduct of business rules. It has been supplemented by a third Finanzmarktförderungsgesetz, which introduced the legal regime for investment firms and the operation of the European passport. The implementation in Luxembourg is mainly contained in two laws: the law of 12 March 1998 which regulates investment firms[48], and two Laws of 23 December 1998, which create an integrated supervisory body for the financial institutions and financial markets, the *Commission de Surveillance du Secteur Financier* on the one hand[49], and the supervision of regulated markets on the other.[50] Delegated regulation is only of minor importance. Finally, the situation in the UK is quite peculiar: implementation of the ISD mostly took place through delegated regulation, namely statutory instruments and regulation by the SIB and the SROs. The reform of the supervisory system over the last two years and currently in its final stage, with the transfer of supervisory powers to the Financial Services Authority, leads to a complete overhaul of the regulatory landscape.

B. Regulation and supervision of investment firms

In several member states, the prudential regulation of intermediaries in the securities business was still in an embryonic stage: while most member states subjected the securities brokerage, and to a lesser extent portfolio management activities, to some form of authorisation, the patterns of supervision still were very diverse and often were not actually of prudential nature. The ISD necessitated substantial modifications in this respect, but left member states some freedom as to the organisation of the legal regime of investment firms:

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47 A complete list of implementation measures, such as notified by the Member States to the European Commission, may be consulted on the Celex database of the European Commission. This list illustrates the diversity of legal instruments which are considered to implement the ISD. See for a reprint of the list WYMEERSCH, E., The Implementation...", *op. cit.*, *supra* note 45, p. 41-44.

48 Law of 12 March 1998 'modifiant la loi du 5 avril 1993 relative au secteur financier aux fins de transposer la directive 93/22/CEE', *Mémorial*, A-23 of 25 March 1998, p. 338.

49 Law of 23 December 1998 'portant création d'une commission de surveillance du secteur financier', *Mémorial*, A-112 of 24 December 1998, p. 2985.

50 Law of 23 December 1998 'relative à la surveillance des marchés d'actifs financiers', *Mémorial*, A-112 of 24 December 1998, p. 2990.

in fact, the directive does not preclude a member state from maintaining different categories of investment firms, according to the investment services offered. Similarly, the member states remain free in determining which activities each sub-category of investment firm may undertake. Of course, these restriction may not be applied to foreign investment firms using their European passport.

For instance, the Belgian law distinguishes between three categories of investment firms (securities firms, portfolio managers and brokers (*courtier*) in financial instruments, for which different prudential requirements, mainly in terms of initial capital, apply. The scope of allowed activities of each category is degressive: securities firms may enter into all core investment activities, as enumerated in Annex A to the ISD, including portfolio management. Investment firms with a licence as portfolio managers are not entitled to underwriting and own dealing activity, but may execute orders in financial instruments. The activity of brokerage in financial instruments between two clients is confined to bringing together two investors with a view to concluding a transaction in a financial instrument between both.
Similarly, the Luxembourg law enumerates five categories of investment firms: commissioners, portfolio managers, professionals dealing for own account, distributors of collective investment units and underwriters of financial instruments.[51]
In France, like in the Netherlands, only two categories of investment firms have been recognised by law: securities firms (*effectenbemiddelaar, entreprise d'investissement)* and portfolio managers (*vermogensbeheerder, société de gestion de portefeuille)*.[52] Other member states, such as Germany, have introduced a single regime for investment firms (*Finanzdienstleistungsinstitute*)[53], putting as a rule firms on the same footing, irrespective of their specific activity. Nevertheless, some regulatory requirements still differ according to the type of activity of the firm, mainly in the field of initial capital.[54]

At the level of prudential supervision of investment firms, the freedom left by the ISD as to the organisation of supervision is reflected in the member states: First, member states may choose to confer supervisory powers upon either a public or a self-regulatory body recognised as such by a public authority.[55] The typical example used to be the UK supervisory system under the Financial Services Act, which served as model for the proponents of self-regulation in continental Europe. In most other member states, the supervisory powers on the intermediaries is entrusted to public authorities, although some notable exceptions exist. For instance, the Dutch supervisory structure traditionally had a high self-regulatory input, as the Amsterdam stock exchange used to exercise (prudential)

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[51] See Art. 24 Law of 12 March 1998, cited supra note 48.

[52] See in the Netherlands: Art. 1 Wet Toezicht Effectenverkeer, *Stb.*, 1995, 574. For France: Art. 7 and 8 Law No 96-597 of 2 July 1996 'de modernisation des activités financières', *JORF*, 4 July 1996, p. 10063.

[53] Defined in § 1 (1a) Kreditwesengesetz as providers of investment services, enumerated in the same provision. The definition does not only include the investment services from Annex A to the ISD, but also: deposit brokerage for non EU-undertakings, the execution of credit transfers and the trade in money (§ 1 (1a) Kreditwesengesetz, as modified by Law of 22 October 1997 'zur Umsetzung von EG-Richtlinien zur Harmonisierung bank- und wertpapieraufsichtrechtlicher Vorschriften', *Bgbl.*, 1997, I, No 71, 28 October 1997, p. 2518).

[54] See § 33 Kreditwesengesetz, as modified by Law of 22 October 1997, cited supra note 53: a distinction is operated according to the possibility to accept or not financial instruments or deposits from clients.

[55] Moreover, the decisions taken by such body must be open for review before the courts, in order to guarantee the rights of individuals under the ISD, and eventually to grant the latter the possibility to have interpretation issue referred to the Court of Justice through a preliminary procedure. see for more details TISON, M., "Financial Self-regulation and EC Directives", *LMCLQ*, 1993, p. 60-78.

supervision over its non-bank members, notably securities firms.[56] This system is increasingly under pressure, due to widespread criticism on the complexity of the supervisory structure.[57] Since 1997, the supervision exercised by the stock exchange has been transferred to the *Stichting Toezicht Effectenverkeer* (STE), the body which was already in charge of supervision on securities firms which are not member of the Amsterdam Exchanges. This transfer of powers has been more recently formalised by law.[58]

A second aspect in the freedom left by the ISD to member state in the organisation of prudential supervision relates to the number of bodies involved in supervision. Most member states attribute the power to grant an authorisation and to exercise prudential supervision on the investment firm to one single body. Some member states have maintained a separation between both functions. This is the case in France, where the *Comité de la Réglementation Bancaire et Financière* grants and withdraws the authorisation, while prudential supervision is exercised by the *Commission Bancaire* as far as credit institutions and investment firms other than portfolio managers are concerned. For portfolio managers, a specific supervisory regime applies, in which the licensing procedure is in the hands of the *Commission des Opérations de Bourse*[59], which also plays an important role in the supervision of market activities. The ongoing prudential supervision is exercised by the *Commission Bancaire*.[60]

More important however is the question as to the separation or integration of supervision over investment firms and credit institutions. Several member states have chosen the path of integrated supervision, putting both categories of financial undertakings under the roof of a single body, mostly the former banking supervisor. This is the case in Belgium (*Commission bancaire et financière*), France (Commission bancaire) and Luxembourg (CSSF). In the United Kingdom, the move to integration goes along with the creation of a new supervisory body, the Financial Services Authority (FSA), to which the prudential powers formerly exercised by the Bank of England in respect of credit institutions have been transferred.[61] In Germany, the creation of a supervisory regime for investment firms (*Finanzdienstleistungsinstitute*)[62] implied an extension of the powers of the banking supervisor (*Bundesaufsichtsamt für das Kreditwesen*) to include supervision on investment firms. In Italy, the integration is less pronounced: the Banca d'Italia is competent for prudential supervision of credit institutions and investment firms, though for the latter some prudential powers have been attributed to the CONSOB. It includes mainly the licensing of investment firms and the supervision of some aspects of the internal organisation of the firm relevant for the relation with investors (segregation of funds, conflict of interest avoidance etc.).[63] A minority of member states shows a preference for

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56 See WYMEERSCH, E., The Implementation...", *op. cit.*, *supra* note 45; GRUNDMANN-VAN DE KROL, C.M., *Koersen door het effectenrecht*, Zwolle, Tjeenk Willink, 1997, p. 245-248.

57 See, for instance, SCHAAFSMA, J.R., "Wettelijke toezichtsstructuren: zelfregulering", in *Ontwikkelingen in het effectenverkeersrecht*, Deventer, Kluwer, 1996, p. 29.

58 Wet Herijking Wet Toezicht Effectenverkeer, *Staatsblad*, 1998, 515. See for comments: VAN EVERDINGEN, H.G., Enige opmerkingen over de structuur van het toezicht op de financiële sector", in *Aspecten van toezicht. Beschouwingen over het toezicht op de financiële sector*, Preadviezen voor de Vereniging voor Effectenrecht 1999, Deventer, Kluwer, 1999, p. 5-7.

59 See Art. 11 Law No 96-597, cited *supra* note 52.

60 Art. 37 I Loi n° 84-46 of 24 January 1984, as modified by Art. 72 Law No 96-597, cited supra note 52.

61 At present, the UK system seems to be, together with Denmark, one of the few in which one body also is vested with supervisory powers over insurance undertakings. One cannot exclude that the UK example will produce spill-over effects on other European countries, in the context of the growing importance of financial conglomerates.

62 See § 1 (1a) Kreditwesengesetz, as introduced by Law of 22 October 1997, cited supra note 53.

63 See WYMEERSCH, E., "The Implementation...", *op. cit.*, supra note 45, p. 23-24.

institutional separation in the supervision on credit institutions and investment firms: for instance, the Netherlands, with a separation between *De Nederlandsche Bank* (credit institutions) and the *Stichting Toezicht Effectenverkeer* (investment firms).[64]

Finally, it should be noted that in some member states (Luxembourg, United Kingdom) the move to integrate prudential supervision on credit institutions and investment firms went along with the insulation of these function from the central bank, which previously exercised prudential supervision on credit institutions. At present, only a minority of member states are characterised by one single authority performing the functions of central banker — or at least of participant in the European System of Central Banks — and prudential authority in charge of banking supervision.[65] On the other hand, only one member state (Ireland) has in addition vested the central bank with supervisory powers over investment firms.

C. Mutual recognition

The operation of the European passport and the principle of mutual recognition does not seem to cause major problems in the EU member states. The main interpretation questions seem to relate to the notification procedure to be accomplished before the first provision of services or in case of remote access to regulated markets in another member state. We have argued elsewhere in the context of the Second Banking Directive that the proposal of the European Commission to use the criterion of "characteristic performance" for the purpose of localising a service within one or another territory, is inadequate and runs contrary to the *ratio legis* of the notification procedure.[66]

Other problems in the operation of the system of mutual recognition might emerge when looking closer at the implementation of the home-host country division of powers in different EU member states. A first difficulty was encountered in the Dutch implementation law, which explicitly deals with the case of deficient implementation of the ISD in the home country of an investment firm wishing to 'passport in' in the Netherlands. The law empowers the Minister of Finance to withdraw the mutual recognition of authorisations granted to investment firms in their home member state when the latter has not properly implemented the ISD. The investment firms are then assimilated to third country investment firms, and would consequently have to apply for an authorisation in the Netherlands. This provision must be held incompatible with the system of mutual recognition laid down in the ISD and with the general principles of Community law which prohibit a member state from unilaterally intervening against another member state which allegedly acts in breach of Community law.[67]

Similarly, the German implementation law stipulates that the mutual recognition of the home country authorisation is valid for those credit institutions and investment firms which are supervised in their home country 'in accordance with the provisions of the EU directives'.[68] If this implies that the Bundesaufsichtsamt can take up full prudential

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64 The separation could in part be tributary to the former prevalence of self-regulation in the operaton of stock exchanges and the supervision over their members, the latter now being under the roof of a separate supervisor which could be considered to be more close to the operation of financial markets.

65 Namely Greece, Spain, Italy, Ireland, the Netherlands and Portugal.

66 See TISON, M., "Lecture critique de la Communication interprétative", *Rev. Banque*, 1998, p. 162-166; compare TAEVERNIER, B., PIJCKE, A.-S., "La Communication interprétative et ses enseignements pour l'interprétation de la D.S.I.", *Rev. Banque*, 1998, p. 152-155; DAX, D., "L'impact...", *op. cit.*, *supra* note 36, p. 6-10.

67 See the European and Belgian case law cited above, notes 43 and 44.

68 See § 53b (1) Kreditwesengesetz, as modified by Law of 22 October 1997, cited *supra* note 53.

competence when the latter condition is not satisfied, the provision will be incompatible with Community law.

The difficulty indicated above in interpreting the scope of the residual powers of the host country competent authorities, laid down in Articles 19(3) to 19(5) and 19(8) of the ISD is reflected in the implementation laws in the member states. In general, member states appear to read in these provisions an actual residual competence of the host state to intervene in case of insufficient supervision by the home state authorities. For instance, the French law enables the *Commission Bancaire* or the *Commission des Opérations de Bourse*[69] to take measures against a foreign investment firm in accordance with the procedures of Articles 19(3-5) or 19(8) ISD when the investment firms does not conform to the home country authorisation requirements or prudential standards.[70] Vague provisions in the Dutch law could be interpreted in the same sense: the supervisor may apply the procedures of Art. 19(3-5) and 19(8) when the foreign investment firm does not abide by the 'supervision rules', without further specification.[71] Other implementation laws on the contrary refer to a residual power to exercise liquidity supervision, while there is no trace of such power granted to the host country by the ISD, contrary to the Second Banking Directive. This is the case in Luxembourg[72] and in Germany.[73] In view of the obligation to interpret national law in conformity with Community law, the extensive interpretation of host country powers in some member states will be overruled.

The Belgian law finally clearly comes in conflict with the home country control principle, when it empowers the Banking and Finance Commission in emergency cases to verify whether the activities of the Belgian branch of a EU investment firm are in conformity with the laws which apply to it and with the principles of a sound administrative and accounting structure and adequate internal controls.[74] This provision has been inspired by a similar recital appearing at the end of the preamble to the Second Banking Directive, the meaning of which remains unclear.[75] As no trace of such a host country power can be found back in the ISD or its preamble, which on the contrary clearly affirms the home country control principle, it has to be concluded that the Belgian law is contrary to the ISD in conferring additional competencies upon the host country supervisors.

D. Transactional regulation and supervision

The regulation of transactions resulting from the provision of investment services covers a variety of rules, ranging from investment firms' membership of (regulated) markets and the obligations arising from it, over the rules applicable to the relation with investors, whether conduct of business rules or other obligations contained in the market regulations. As mentioned, the ISD effects only limited harmonisation in this field, mainly with respect to conduct of business.

In general, the implementation of these rules in the EU member states is closely connected with the financial market reforms provoked by the ISD and the growing

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[69] When a portfolio manager is involved.

[70] Article 79 III Loi n° 96-597, cited *supra* note 52.

[71] Art. 12 Wet Toezicht Effectenverkeer 1995, cited *supra* note 52.

[72] Art. 46(3) Loi 5 avril 1993, as modified by Law of 23 March 1998, cited *supra* note 48.

[73] See § 53b (d), referring to § 11 Kreditwesengesetz, as modified by Law of 22 October 1997, cited *supra* note 53.

[74] See Art. 12, § 1 (2) Royal Decree of 20 December 1995, *Moniteur*, 6 January 1996.

[75] See for more details TISON, M., *De interne markt...*, *op.cit.*, *supra* note 10, p. 696, para 1370.

competition between exchanges. Without entering into details[76], two tendencies can be distilled from the new supervisory structures put in place in the post-ISD market reforms: first, most member states separate prudential supervision from transactional supervision on the activities of investment firms. The latter aspect of supervision, including the conduct of business rules, is generally brought closer to the markets. Very often, the supervision of conduct of business rules will be entrusted to the authorities which are responsible for supervision of the regulated markets from which the investment firm is a member. In Belgium, supervision lies in the hands of the executive board of the Brussels Exchange and other regulated markets, acting as independent market authority. In France, the newly created professional body responsible for supervision of the regulated markets, the *Conseil des Marchés Financiers* (CMF) is also designated as competent authority for the supervision of conduct of business rules to be observed by investment firms and credit institutions.[77] A similar division of responsibilities exists in Germany: the *Bundesaufsichtsamt für den Wertpapierhandel* (BAWe) is competent for supervising the conduct of business rules of investment firms and credit institutions offering investment services[78], which supplement its competencies in the field of financial market supervision, notably with respect to insider dealing, *ad hoc* information by listed companies and the notification of significant holdings in listed companies.

An exception to the separation between prudential and transactional supervision is Luxembourg, which has recently opted to fully integrate both functions: the *Commission de Surveillance du Secteur Financier* (CSSF) is, in its capacity of prudential authority, responsible for supervision of all financial institutions in the banking and securities field, taking over the functions formerly performed by the *Institut Monétaire Luxembourgeois* (IML), which was both prudential supervisor and central banker. In addition, the CSSF is designated as 'competent authority' for the supervision of financial markets[79], which includes the duty to supervise the application of the trading rules, and the rules on reporting and transparency imposed by the ISD. The law does not clarify, however, who is competent for supervising the conduct of business by investment firms[80], but stipulates that the CSSF may withdraw the authorisation of an investment firm in the event of serious and systematic non-compliance with the conduct of business rules.[81]

With respect to the home-host country division of responsibilities in the field of transactional rules, the implementation laws in the different member states confirm the risk of duplication of regulatory and supervisory jurisdiction in a cross-border setting. On the one hand, most member states apply their conduct of business rules to the activities of domestic investment firms and credit institutions in general, irrespective of the localisation

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[76] See in this respect the description of the different market supervisory structures post-ISD by Wymeersch, E., "The Implementation...", *op. cit.*, *supra* note 45, p. 15-30.

[77] The CMF also has the power to enact the conduct of business rules it supervises, except for portfolio managers, where regulatory competence is attributed to the Commission des Opérations de Bourse. See Art. 58 Loi n° 96-597, cited *supra* note 52

[78] See § 35 Wertpapierhandelsgesetz, as modified by Law of 22 October 1997, cited supra note 53.

[79] See Art. 2 Law 23 December 1998 'portant création d'une commission de surveillance du secteur financier', cited supra note 49.

[80] Art. 37 Law 5 April 1993, as modified by Law of 12 March 1998, cited supra note 48, enumerates, in line with Art. 11 ISD, the conduct of business rules to which investment firms and credit institutions should conform in the exercise of their activities. Art. 42 of the same law designates, however, the IML - now the CSSF - as competent authority for the supervision of *prudential* rules. As the law makes a clear distinction between prudential rules (Art. 36) and conduct of business rules (Art. 37), it may be submitted that not the CSSF is to be considered competent for the supervision of conduct of business rules, but that this will form part of the supervision exercised by the Stock Exchange over its members.

[81] Art. 23(4) Law 5 April 1993, as modified by Law of 12 March 1998, cited supra note 48.

of their activities in the home country or abroad. On the other hand, all member states take up jurisdiction for conduct of business rules in relation to incoming investment firms and credit institutions authorised in another EU member state, in their quality of 'member state where the investment service is provided'. None of the national implementation laws makes any reference to a limitation of host country jurisdiction with reference to the general good exception. When such reference appears, it is under the assumption that the application of the host country rules of conduct *de plano* satisfies the general good test.

E. Regulated markets

The implementation of the concept of 'regulated market' in the EU Member States has not given rise to particular problems. Except for a few limited technical difficulties raised in some countries by the transparency and reporting requirements, no fundamental difficulties are encountered as regards the interpretation of the notion of 'regulated market' itself. One problem reported to the Commission by Italy and Spain concerned the implications of a transaction whereby both financial instruments within the meaning of ISD and commodity derivatives, not covered by the definition of 'financial instruments' are traded on a regulated market established in another member state. As the market segment relating to the commodity derivatives trading does not qualify as 'regulated market' for application of the ISD, the member states feared the uncertainty as to whether or not that market segment could benefit from mutual recognition under Community law.[82]

This question raises a more fundamental issue as to the latitude given by Community law to the Member States in restricting the conduct of transactions on non-regulated markets which are not covered by the ISD, notably those relating to instruments which are not 'financial instruments' within the meaning of the ISD. In general, all restrictions imposed upon financial intermediaries or investors to conduct transactions in such instruments on a market in another member state are to be considered restrictions to freedom to provide services or free movement of capital, which can be maintained solely under the general good exception. As for the situation of intermediaries, no European passport principle applies comparable to the ISD, but the host member state must have regard to the regulation and prudential standards applied in the home state when assessing the conditions imposed by its domestic law on the activity of such intermediaries, and possibly waive the application of some of its domestic requirements to the foreign intermediary. On the other hand, a member state cannot prohibit its residents or intermediaries from moving away from domestic markets and have transactions in certain instruments executed on a foreign market. This does not prejudice, however, the possible application of rules of investor protection which oblige (non-sophisticated) investors to have recourse to a financial intermediary to have the transaction executed, and which oblige the intermediary to execute an order on the market. When assessing such restrictions under the general good, useful indications might be found in the conditions attached to the concentration rule in the ISD. Finally, it may be submitted that in the field of transactional rules, host member states have a wider discretion in applying their domestic rules to foreign intermediaries for reasons of investor protection, in particular when the instruments traded are highly risky. As was illustrated in *Alpine Investments*, such restrictions may take the form of an absolute ban on certain (aggressive) ways of advertising services.[83]

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[82] See European Commission, *Investment services directive...*, cited *supra* note 24, p. 8.

[83] ECJ; 10 May 1995, *Alpine Investments*, case C-384/93, *E.C.R.*, 1995, p. I-1141, which upheld the prohibition under Dutch law on cold calling for transactions on commodity futures as being necessary to preserve financial market confidence.

A look at the list of regulated markets, as communicated by each member state to the European Commission[84], reveals that most member states have put their traditional stock exchanges and associated derivative markets on the list of regulated markets. Interestingly, the markets comprising the London Stock Exchange also figure on the list, which illustrates the limited effect of the compromises reached by the ISD in delimiting the different concepts of securities markets. Once it became possible for SEAQ-I to qualify as regulated market, its competitive situation would not be hampered by the protective effect of the concentration rule**.** A second common feature relates to the status of the new markets for growth companies or smaller firms: both EASDAQ and the network of 'nouveaux marchés' created in several member states have received the status of regulated market. This illustrates the obvious international profile of these markets, which from the outset try to attract capital across the domestic borders. Thirdly, the emergence of so-called proprietary trading systems in some member states, which in essence are private commercial undertakings offering a trade platform for specific financial instruments, is reflected to a limited extent in the list of regulated markets. The most illustrative example is Tradepoint plc, a UK based auction system for mainly large transactions in securities which are also listed on the London Stock Exchange, and which therefore is a direct competitor to the latter.[85] Finally, it should be noted that the member states in which separate professional markets for government debt exist, also have put these on the list of regulated markets. In the prospect of EMU and growing internationalisation of government debt management, this movement will probably gain importance in the near future.

As indicated above, it should be stressed that a considerable group of member states, although adhering to the concept of 'regulated market' for their domestic markets, do not institute any concentration requirement with regard to transactions in instruments traded on them. It illustrates a clear liberal approach adopted by these countries, where the dimension of internationalisation and mutual recognition of the 'regulated market' appears at the forefront. It raises the question to which extent the concentration rule in itself will be remain of relevance in the future: in the end, the markets themselves, by preserving investor confidence, will manage to maintain sufficient liquidity and hence to attain by themselves the objectives pursued by the concentration rule.

It is still unclear to which extent the ISD and the concept of regulated market is modifying the basic concepts of financial market organisation in the individual member states. The "public utility" approach prevailing in most continental European states, in which the markets are created through concession by the state or through a government act, does not seem to be fundamentally put in question, although more opportunities are offered for reform of the traditional stock exchanges into clear business oriented units on the one hand, and the deployment of parallel private initiatives on the other. At the one end of the spectrum, some member states still adopt the concession approach: a stock exchange or other financial market may only be created through concession by the state, who also formulates the conditions for obtaining and keeping the concession. This is for instance the case in Luxembourg.[86] Under this approach, the exchange still is viewed as a 'natural

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[84] A first list was published in *OJ* C 203 of 3 July 1997. An update is given in European Commission, *Investment services directive...*, cited *supra* note 24, p. 11-12.

[85] See in this respect RUDOLPH, B., RÖHRL, H., "Grundfragen der Börsenorganisation aus ökonomischer Sicht", in HOPT, K.J., RUDOLPH, B., BAUM, H. (eds.), *Börsenreform. Eine ökonomische, rechtsvergleichende und rechtspolitische Untersuchung*, Stuttgart, Schäffer-Poeschel Verlag, 1997, p. 158-159.

[86] See Art. 1 Loi 23 December 198 relative à la surveillance des marchés d'actifs financiers, cited note 50, which subjects the creation of a 'bourse' to a government concession. The same provision appoints the 'Société de la bourse de Luxembourg' as market benefiting from a concession until 21 March 2027.

monopoly'[87], which at present will be subject only to more severe international inter-exchange competition. Likewise, in France the stock exchanges are recognised by law and enjoy a domestic monopoly in the trading of financial instruments. The Belgian law is less pronounced: it operates a distinction between stock exchanges, which are recognised by Royal Decree, and 'other markets', which may be created or organised by royal decree if regulation is deemed necessary in the interest of the development of Belgium as financial centre or in order to protect the persons which have access to these markets.[88] An important deterrent to inter-exchange competition was however introduced in the Belgian law: when the 'other market' would trade in categories of financial instruments already negotiated on an existing Belgian market, the latter should give its consent with the creation or organisation of the new market, unless otherwise provided in the royal decree creating or organising the latter. However, it should be noted that Belgian law only speaks of a *possibility* for government to intervene in the creation or organisation of 'other markets', which does not preclude the creation of a market outside this frame. Nevertheless, a restriction could flow from the obligation to have an authorisation as investment firm each time an enterprise wishes to act as 'courtier' in financial instruments, bringing together clients in order to have transactions in financial instruments concluded amongst them. It may therefore be submitted that setting up a proprietary trading system would require an authorisation as investment firm by virtue of the ISD itself, and hence not only in Belgium, but also when established in other EU member states.

Part III - Beyond ISD and EMU: prospects for financial market development

The growing competitive environment created by the ISD, but, more importantly, by the lifting of (psychological) barriers to cross-border investment after Economic and Monetary Union, is dramatically modifying the micro-structure of the financial markets. Fierce inter-exchange competition in a business oriented climate, fostered by the international mobility of exchanges and their intermediaries, is gradually taking the place of previously dominant national protection of financial markets by public authorities. In this new environment, the small exchanges will have to find a new role if they do not wish to be swept away by the large exchanges, while the latter must seek ways to consolidate their position in the European context. Surprisingly, the strategic reaction by both smaller and bigger exchanges is largely similar, and based on co-operation agreements and alliances. After a brief description of the main alliance projects currently under way, we will try to identify a few legal issues surrounding these evolutions.

1. Inter exchange co-operation and alliances

The different co-operation initiatives between European exchanges are characterised by their diversity in objectives, scope and substance, reaching from mere technological co-operation agreements, over setting up inter-exchange interconnections for mutual access to trading, to setting up a common structure for trading in specific financial instruments. The most illustrative example of the latter is the 'European Alliance' set up between the London and Frankfurt exchanges, which aimed at creating a common trading platform for European blue-chips, and which was rapidly extended to other major exchanges (Amsterdam, Brussels, Madrid, Milan, Paris, Zürich). The latter were initially only granted 'observer status' in the bilateral talks between London and Frankfurt, but more recently fully joined

[87] Compare FERRARINI, G, *op. cit.*, cited note 21, p. 572.
[88] Art. 30 Law 6 April 1995, *Moniteur*, 3 June 1995.

the alliance.[89] The ultimate objective of the alliance is to create a joint stock market for Europe's 300 top companies operating under a single trading platform and common trading rules. Although the structure has not yet been set up, several preparatory measures have already been adopted: since January, London and Frankfurt offer their members mutual access to each other's markets and have repatriated trading in each other's listed securities in order to enhance domestic liquidity.[90] Some key issues in the run up to the alliance are still unclear, such as the ownership structure of the new market and the choice of an equity index.
Beside this pan-European initiative, regional co-operation structures have been set up between mainly smaller exchanges, some of which do also participate in the European Alliance. The two main initiatives at present are NOREX and the Benelux Agreement. NOREX is a co-operation structure set up between the Stockholm and Copenhagen exchanges, with the ambition of including other Scandinavian and possibly Baltic exchanges in the creation of a common Nordic securities market.[91] The integration follows a double track: the use of a common trading system by the participating exchanges, and achieving homogeneity in the membership of the respective exchanges through cross-membership. The Benelux Agreement, reached between the Amsterdam, Brussels and Luxembourg equity exchanges mainly focuses on cross-membership as driving force for integration: applying the principle of mutual recognition which characterises the 'European passport' for investment firms and credit institutions under the ISD, members of one of the participating exchanges may apply for membership of the other participating exchanges without having to satisfy to all conditions imposed on membership of the host country exchange. 'Cross membership' does not imply any physical presence in the host country: it constitutes a particular form of 'remote membership' of the exchange with less burdensome entry conditions than under regular remote access[92], by derogation of Article 15.1 ISD.

Notwithstanding substantial differences between the various co-operation initiatives, some common features may be identified. First, the scope of inter-exchange co-operation generally appears to be limited: no full mergers of markets are envisaged but at most a common structure for a specific segment of the market, beside technical co-operation with a view to cost reduction. Second, the techniques to achieve inter-exchange integration are largely similar: over the past 15 years, the efforts to achieve a European capital market both at the level of the European Commission and within the Federation of European Stock Exchanges focused on multiple listing of securities (cf. Euroquote, Eurolist). The approach presently emerging is radically different: mobility of the markets by placing screens in other member states and international mobility of the market intermediaries make multiple listing superfluous: even a single listing in the 'domestic' market can provide access to a wider, pan-european investment public. The inter-exchange co-operation projects are in line with this approach: cross membership and international access to trading enables to repatriate trading in securities to their domestic markets instead of fragmentation over different exchanges. As a consequence, arbitration between different exchanges is reduced, and liquidity is concentrated in the 'domestic' market of the issuer.

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[89] See BOLAND, V., "Pan-european exchange moves closer", *Financial times*, 5 May 1999.

[90] See BOLAND, V., "Europe's exchanges meet to bolster alliance", *Financial* times, 18 December 1998; BOLAND, V., "European markets to harmonise trading", *Financial times*, 10 March 1999. Neither of these measures was reported to have dramatic effects since non-domestic trading volumes were relatively low and most larger brokers and investment banks already were member of both exchanges.

[91] Se for an outline of the main provisions of the Norex-agreement: Skaanning-Jorgensen, P.E., "NOREX - Nordic Exchanges", *Rev. Banque*, 1999/6, p. 266-267.

[92] Compare TAEVERNIER, B., PIJCKE, A.S., "La convention de cross membership Bénélux: contenu et perspectives", *IBLJ*, 1999/3, p. 259-261.

2. Emerging legal issues

The developments of financial markets over the past few years under the influence of ISD and EMU raise new legal issues in different fields. The emerging questions are highly complex, while the market evolutions still are in part uncertain. We will therefore simply indicate some of the questions which might arise in the near future, without any ambition to provide answers.

a. Inter-exchange co-operation and competition

A major point of attention for the European Commission in the near future will be to scrutinise the various inter-exchange co-operation agreements for their effects on competition between exchanges. To the extent that the co-operation leads to substituting a single trading platform to competition for trading in specific securities, the agreements may be considered to produce anti-competitive effects in the relevant market, and may run contrary to Article 81 EC Treaty. These will have to be outweighed by the benefits deriving from the co-operation in terms of lower transaction costs and more security for investors, and may not lead to totally eliminating competition.[93] The issue is crucial: although it might be beneficial for a European capital market to operate under larger structures of regulated markets, the integration process may not lead to a situation where previous national monopolies in the hands of stock exchanges are substituted by the private monopoly of a European 'super exchange'. At first sight, the co-operation movement does not yet seem to entail substantive anti-competitive effects. In fact, the actors frame their co-operation projects in a context of "coopetition" in which inter-exchange competition and co-operation are said to coexist.[94]

b. Demutualisation of stock exchanges

The changing competitive environment is putting the traditional stock exchange ownership structures under pressure: the needs of exchanges for additional capital in order to follow technological developments in trading and clearing systems cannot be further satisfied with the co-operative membership based structure. As a consequence, several stock exchanges are transforming into mostly public limited companies, making their share capital available to a wider public. This has been the case already in the past with the Stockholm exchange. More recently, the Brussels stock exchange was transformed into a *société anonyme*, but its share capital is at this stage still closely held. Interestingly, a similar movement is witnessed in the US, with the announcement by the NYSE that it will demutualise. In a further stage, the exchanges might even have their shares listed on their proper exchange, as is already the case in Stockholm and would happen with NYSE.[95] This might give rise to new legal issues in terms of supervision: to the extent that the market themselves exercise supervisory responsibilities, e.g. in the fields of information obligations, transparency requirements and insider dealing, the supervision of the company organising the stock exchange and listed on it will have to offer sufficient guarantees of independence. Some form of second-line supervision, as exists under the Belgian regime, might be helpful to supplement supervision by the market authorities.

c. The emergence of Proprietary Trading Systems (PTS)

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93 See in particular the conditions for exemption under Article 81(3) EC Treaty.

94 The term is inspired by Goldfinger, Ch., "Les lignes de force et de faiblesse économiques et technologiques des marchés de valeurs mobilières en Europe", *Rev.* Banque, 1994/10, p. 522-524; See also TAEVERNIER, B., PIJCKE, A.S., "La convention...", *op.cit.*, supra note 92.

95 See LUCE, E., LABATE, J., "The trading bell tolls", *Financial Times*, 26 July 1999.

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Traditional stock exchanges and regulated markets are said to increasingly suffer from the competition of new entrants in the market for trading services. These are indicated by way of different acronyms: Proprietary Trading Systems (PTS), Electronic Communication networks (ECN) or Alternative Trading Systems (ATS). These quasi-exchanges offer alternative and cheaper computer systems for order matching and, as the case may be, settlement. As a consequence, they enable mostly professional investors to by-pass the markets, thereby also economising on brokerage fees. Sometimes, the PTS is devised as a trading system within an existing market between a limited number of (important) members, providing a cheaper trading platform for larger transaction beside the existing trading system.
The functions performed by these PTS vary considerably: some are confined to provide pre-trading information through order crossing, without disposing of an independent price discovery mechanism (e.g. Posit in the US); other systems organise an actual auction market, which may be either continuous (e.g. Instinet ,Tradepoint) or not (e.g. AZX: daily auction after closing of the NYSE).[96] Recent figures show the relative importance of these PTS in number of transactions. For instance, the average daily transactions on securities listed in the NYSE conducted through Instinet, which is a 100% subsidiary of Reuters, amount to around 165 million. In recent years, the larger investment banks have played an important role in the creation of new PTS, such as Brass Utility, Archipelago and Strike Technology,[97] or have entered in the share capital of existing trading systems (e.g. Tradepoint).[98]
These PTS are not only direct competitors to the stock exchanges or other markets in countries which do not impose far-reaching centralisation requirements. Competitive pressure from the newcomers will also be felt in the member states which still impose a concentration requirement for transactions in financial instruments negotiated on a regulated market: institutional investors must have possibilities to waive the concentration rule under circumstances adapted to their professional nature, and should therefore be in a position to easily take recourse to the services of a PTS outside the regulated markets.

In legal terms, the emergence of the new trading systems raises questions as to adequacy of the present regulatory framework under the ISD, notably when it comes to determining the extent to which a member state may restrict the operation of a PTS on its territory, whether it is home based or established abroad. As the ISD only deals with the legal regime and international status of *regulated* markets, the field of other markets or trading systems remains largely under the regulatory powers of the individual member states. As already indicated, it is not excluded that a PTS might qualify as investment firm, when its services consist of bringing together two clients-investors with a view to effecting transactions in financial instruments. To illustrate this: while Instinet functions legally as a broker, and in this capacity has become member of different exchanges in and outside Europe, Tradepoint has the status of (regulated) market in the UK..[99] This might indicate that the definitions in the ISD are not adapted to the changing concept of financial markets as providers of specific trading and settlement services, which are to be distinguished from the intermediaries active on the market. The need to further clarify the issue has been acknowledged by the European Commission: the recently published Action Plan for financial services stresses the need to adopt a common approach to the authorisation and

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[96] For an overview see STEIL, B., "Equity Trading I: The Evolution of European Trading Systems", in *The European Equity Markets, The State of the Union and an Agenda for the Millennium*, B. STEIL (ed.), London, RIIA, 1996, p. 44.

[97] Investment banks such as Goldman Sachs, Merrill Lynch or J.P. Morgan have important capital stakes in these companies.

[98] See PRUDHOMME, C., RENAULT, E., "Les marchés privés électroniques en Europe menacent l'existence des Bourses classiques", *Le Monde*, 16 September 1999.

[99] STEIL, B., "Equity Trading I", *op. cit., supra*, note 96.

supervision of alternative trading systems.[100] It is clear that this approach will have to take into consideration the wide diversity in the functions performed by these systems, and their relation with, or possibly integration within existing (regulated) markets.
Furthermore, the question arises to which extent the PTS will benefit from the Treaty freedoms by offering their trading services to investors in other EU Member States. If the PTS qualifies as investment firm, the logical consequence of it is the right to offer the trading services abroad using the European passport regime under the ISD. It is, however, at present unclear whether all member states would grant 'investment firm' status to a PTS. In the end, it will be up to the Court of Justice to clarify the interpretation question.

d. Obsolescence of the 'official listing' concept ?

The emergence of the concept of 'regulated market' as centrepiece in the financial market architecture of the ISD is quite different from the approach which prevailed in the European securities directives of the 1970s and 1980s. The directives on admission of securities to listing and the prospectus directive, later supplemented to include mutual recognition of prospectuses, were adopted in a period of prevalescence of the "public utility" approach to financial markets: the directives concerned the 'official listing' on a 'stock exchange'. The definition of 'regulated market' in the ISD refers to the 'official listing' concept, but leaves room to the member states to separate both: according to Article 1.13 ISD, a regulated market is one in which specific rules exist for admission of financial instruments to the market. These rules should only conform to the 1979 listing particulars directive when the latter is applicable, i.e. in case of 'official listing' on a 'stock exchange' situated or operating in an EU Member State.[101] With the blurring of frontiers between the traditional stock exchanges and other 'regulated markets' in the post-ISD era, it may be doubted whether the very concept of 'official listing' should be maintained.[102] Some have advocated the suppression of the listing particular directives form an antitrust perspective, and would prefer leaving determination of listing conditions to the market.[103] The same author further questions the adequacy of maintaining the 'multiple listing' approach as instrument of market integration in the listing particulars and prospectus directives.[104] Although it is true that at present the integration movement seems to be directed more towards concentration of listing than on multiple listing, it would seem inappropriate to impose this approach to the market. An alternative could be to modify the prospectus directives in order to extend mutual recognition of prospectuses to multiple negotiation of securities on similar regulated markets in general. Some member states already adopt a more liberal approach towards mutual recognition of prospectuses, extending it beyond the confined area of official stock exchange listing.[105]

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[100] See EUROPEAN COMMISSION, "Financial Services: Implementing the framework for financial markets: Action plan", COM (1999) 232, 11 May 1999, p. 6

[101] See Art. 1 Directive 79/279/EEC.

[102] In some Member States, this evolution is visible through changes in terminology. For instance, in France, the legal notion of 'official listing' has disappeared along with the transformation of the stock exchanges into commercial entities, and be replaced by the notion of 'premier marché' of the Paris Bourse (see DE VAUPLANE, H., BORNET, J.-P., *Droit des marchés financiers*, Paris, Litec, 1998, p. 386). However, the modification lies exclusively in terminology, which implies that the conditions for admission and prospectus requirements on the 'premier marché' still comply with the European directives applicable to 'official listing'.

[103] See FERRARINI, G., *op. cit.*, supra note 21, p. 573-574.

[104] FERRARINI, G., *op. cit.*, supra note 21, p. 577.

[105] See for instance in Belgium Royal Decree of 6 July 1999, *Moniteur*, 27 July 1999, which empowers the Banking and Finance Commission to waive the prospectus requirement in case of admission to listing on a Belgian secondary market, other than the first market — on which official listing takes place — of a financial instrument which is already traded on a foreign secondary market which offers equivalent guarantees to the investors as the Belgian market.

e. ISD, EMU and corporate governance

Finally, an important area of market development relates to the impact of financial market integration and EMU on corporate governance structures in the EU member states. The ongoing competition between exchanges, exchange structures and interpenetration of financial markets will undoubtedly have influence on the ownership structure of listed companies, and on investor behaviour in the markets in general. The traditional dichotomy of ownership structure in the continental European countries and the UK might come under pressure, as investors — both institutional and smaller — are offered more diversification opportunities in investment. From the perspective of the issuers, it may be expected that enhanced competition will promote international 'shopping' for capital, whereby companies will increasingly concentrate the demand for capital on the exchange which offers the best investor base and regulatory environment. Although at present this usually corresponds to the domestic market[106], it is not excluded that the ever increasing mobility of capital in a single market might induce changes in this pattern. In addition, it may be expected that the relative importance of in-house bank or holding company financing prevailing in some countries might diminish as a consequence of more attractive market conditions. Closely held or family owned companies will increasingly go public if the market is prosperous. These evolutions will in turn have influence on the governance issues.[107] It may be submitted that the medium term impact of financial market integration will be considerable. Anyway, there is still considerable scope for research in this area, including the question if any regulatory answer should be provided to these profound mutations.

[106] As a matter of fact, the ongoing alliances between stock exchanges are in part aiming at restoring the dominance of the domestic market of issuers in securities trading.

[107] See WYMEERSCH, E., "Corporate Governance after the Investment Services Directive", *EFSL*, 1996, p. 98-99.