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Abstract

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

THE RECIPROCITY REQUIREMENT OF THE SECOND BANKING DIRECTIVE OF THE EUROPEAN ECONOMIC COMMUNITY REVISITED

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In the last issue of the *Fordham International Law Journal*, the authors discussed¹ the European Communities' Proposal for a Second Council Directive on the Coordination of Laws, Regulations and Administrative Provisions Relating to the Taking-up and Pursuit of the Business of Credit Institutions and Amending Directive 77/780/EEC (the "Second Directive").² The authors especially analyzed the question of how the Second Directive will affect non-EEC banks.³

Article 7 of the Second Directive, as originally submitted on February 23, 1988, by the Commission of the European Communities (the "Commission") to the Council of Ministers of the European Communities (the "Council"), introduced a requirement of reciprocity⁴ for the establishment or the acquisition of a credit institution subsidiary⁵ by a non-EEC person.⁶ This reciprocity would have been an EEC-wide reciprocity, i.e., credit institutions from all Member States of the EEC were expected to enjoy reciprocal treatment in the country of the applying non-EEC bank or person.⁷ Reciprocity was to be en-

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1. Gruson & Nikowitz, *The Second Banking Directive of the European Economic Community and Its Importance for Non-EEC Banks*, 12 *FORDHAM INT'L L.J.* 205 (1989).

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

3. See Gruson & Nikowitz, *supra* note 1, at 228-41.

4. See Gruson & Nikowitz, *supra* note 1, at 228-29.

5. See *id.* at 220-22.

6. Second Directive, *supra* note 2, art. 7, at 4; see Gruson & Nikowitz, *supra* note 1, at 228.

7. See Second Directive, *supra* note 2, art. 7(5), at 4; see Gruson & Nikowitz, *supra* note 1, at 228.

forced by means of an advance consultation procedure with the Commission initiated by the Member State, during which the competent authority of the Member State had to suspend its decision on the request by a non-EEC person to establish or to acquire a subsidiary credit institution.⁸ Within three months, the Commission was supposed to have examined "whether all credit institutions of the Community enjoy reciprocal treatment, in particular regarding the establishment of subsidiaries or the acquisition of participations in credit institutions in the third country in question."⁹ If the Commission would have found that reciprocity was not ensured in the country of the non-EEC person, supposedly against an EEC-wide standard, it would have had the right to suspend the decision of the Member State to permit the *de novo* formation or acquisition.¹⁰

It was not possible to predict how narrowly or broadly the reciprocity requirement, as it was contained in the original article 7 of the Second Directive, would have been construed. If reciprocity had meant "absence of discrimination," reciprocity would have existed between the United States and the EEC,¹¹ because the United States subscribes to the principle of "national treatment."¹² However, if the EEC had intended to apply a kind of "mirror-image" reciprocity requirement, under which a foreign credit institution's access to a country's financial markets is conditioned on that country's own credit institutions receiving privileges in the foreign market identical to those in the home market, then difficult questions would have arisen.¹³

The requirement of reciprocity and the procedure for examining reciprocity were the subjects of much criticism from

8. See Second Directive, *supra* note 2, art. 7(2)-(7), at 4; see also Gruson & Nikowitz, *supra* note 1, at 228.

9. See Second Directive, *supra* note 2, art. 7(5), at 4; see also Gruson & Nikowitz, *supra* note 1, at 228-29.

10. See Second Directive, *supra* note 2, art. 7(6), at 4; see also Gruson & Nikowitz, *supra* note 1, at 229.

11. See Gruson & Nikowitz, *supra* note 1, at 229-30.

12. See *id.* at 213 n.39, 229 n.132; Comm. on Int'l Banking, Sec., and Fin. Transactions, N.Y. State Bar Ass'n, *Issuance of Securities by Foreign Banks and Their Finance Subsidiaries Under the Investment Company Act of 1940 and Rule 6c-9*, N.Y. INT'L L. REV., Winter 1988/89, at 29, 36 (E.T. Patrikis, Chairman, and E. Gewirtz and M. Gruson, Reporters).

13. See Gruson & Nikowitz, *supra* note 1, at 230.

non-EEC countries and from some EEC Member States. The United States feared that the Glass-Steagall Act¹⁴ and the prohibition against interstate banking in the United States would be the basis for a finding by the Commission that reciprocity did not exist with the United States.¹⁵ In addition, the power of banks to acquire non-banking subsidiaries is far more restricted in the United States than in the EEC.¹⁶ England feared that the reciprocity examination by the Commission could endanger England's role as leading international banking center and as port of entry for foreign banks¹⁷ and rejected the Commission's right to turn down a third country request for the establishment of a credit institution on English soil.

In response to the international criticism, the Commission decided, on April 13, 1989, to revise article 7 of the Second Banking Directive and to regulate the establishment or the acquisition of credit institution subsidiaries by non-EEC persons in a different manner.¹⁸ The revised article 7 of the Second Directive ("Revised Article 7") still requires that a Member State inform the Commission of any request by a non-EEC person to establish a subsidiary credit institution or to acquire a participation in a credit institution resulting in a credit institution becoming an EC subsidiary¹⁹ of a non-EEC parent.²⁰

In addition to the information given to the Commission regarding specific applications, Revised Article 7(2) requires each Member State to inform the Commission "of any general difficulties encountered by their credit institutions in establishing or carrying out banking activities in any third country."²¹

Revised Article 7(3) requires that the Commission "shall,

14. The Banking Act of 1933, Pub. L. No. 73-66, ch. 89, 48 Stat. 162 (codified as amended in scattered sections of 12 U.S.C.); see Gruson & Nikowitz, *supra* note 1, at 233-35.

15. See Gruson & Nikowitz, *supra* note 1, at 232-37.

16. See *id.* at 237-39.

17. See CLIFFORD CHANCE, *BANKING* 1992, at 88 (1989).

18. Comm'n Information Memo, COM(89) 190, Apr. 13, 1989 [hereinafter Information Memo].

19. For the definition of "subsidiary" for the purpose of the Second Directive, see Gruson & Nikowitz, *supra* note 1, at 225 n.107.

20. Information Memo, *supra* note 18, art. 7(1), at 3. A subsidiary of a non-EEC parent that is "authorized" as a credit institution by the competent authorities of a Member State will benefit from the principle of mutual recognition. See Gruson & Nikowitz, *supra* note 1, at 241.

21. *Id.* art. 7(2), at 3.

initially not later than six months before the Directive enters into force and then periodically, draw up a report examining the treatment of Community credit institutions."²² This report is to be in regard to "the establishment and carrying out of banking activities, and the acquisition of participations in credit institutions of third countries."²³ The Commission is required to submit this report to the Council.²⁴

On the basis of such reports, or at any other time, if the Commission believes that a third country is not granting to EEC credit institutions "*effective market access and competitive opportunities comparable to those accorded by the Community to credit institutions of that third country*,"²⁵ suitable proposals may be submitted by the Commission to the Council "with a view to achieving such comparable access and competitive opportunities through negotiations between the Community and the third country in question."²⁶

Additionally, on the basis of reports submitted under Revised Article 7(3), or at any other time, if the Commission believes that EEC credit institutions do not "enjoy *national treatment and the same competitive opportunities as domestic credit institutions* in a third country and that the condition of *effective market access* has not been secured,"²⁷ the Commission may, in addition to proposing negotiations with the third country, decide that Member States' authorities "shall limit or suspend their decisions regarding requests for new authorizations and acquisitions" by persons of the third country in question, using the procedure provided for in article 20 of the Second Directive.²⁸

Under Revised Article 7, the Commission no longer has the authority to suspend the decision of a Member State to permit the de novo formation or acquisition in a particular case. The Commission has two options:

22. *Id.* art. 7(3), at 4.

23. *Id.*

24. *Id.*

25. *Id.* art. 7(4), at 4 (emphasis added). Compare *id.* with § 3501(b)(1) of the Primary Dealer Act of 1988, 22 U.S.C.A. § 5342(b)(1) (West Supp. 1988) ("same competitive opportunities").

26. Information Memo, *supra* note 18, art. 7(4), at 4.

27. *Id.* art. 7(5), at 5 (emphasis added).

28. *Id.*; see Second Directive, *supra* note 2, art. 20, at 9.

(i) Under Revised Article 7(4),²⁹ if the third country does not accord reciprocal treatment to EEC credit institutions (i.e., it does not accord the EEC credit institutions "competitive opportunities comparable to those accorded by the Community to credit institutions of that third country"), the Commission may propose to the Council to achieve reciprocity by way of negotiation. The Commission has the same right if a third country does not accord EEC credit institutions "effective market access."³⁰

(ii) Under Revised Article 7(5),³¹ if a third country discriminates against EEC credit institutions (i.e., it does not accord to EEC credit institutions "national treatment and the same competitive opportunities as domestic credit institutions"), the Commission may decide that the Member State shall generally restrict or suspend their approvals of establishments of credit institution subsidiaries and of acquisitions of participations in credit institutions by persons of the discriminating country. Revised Article 7(5) considers discrimination to be an event that calls for the most serious reaction by the EEC.³²

Revised Article 7(4), dealing with reciprocity, as well as Revised Article 7(5), dealing with discrimination, mention lack of "effective market access" for EEC credit institutions as a triggering event.³³ The meaning of this term is not clear. "Market" could be a geographical market or a product or service market. It is possible that Revised Article 7 requires access by EEC credit institutions to the same product or service markets in the third country to which non-EEC credit institutions have access in the EEC. In that case, lack of "effective market access" would be a case of lack of reciprocity. If EEC

29. Information Memo, *supra* note 18, art. 7(4), at 4; *see supra* notes 25-26 and accompanying text.

30. Information Memo, *supra* note 18, art. 7(4), at 4.

31. *Id.* art. 7(5), at 5; *see supra* notes 27-28 and accompanying text.

32. The effect of Revised Article 7(5) could be avoided if a bank from a discriminating country sets up a banking subsidiary in a non-discriminating country, which in turn seeks in a Member State approval for the establishment of a credit institution subsidiary or for the acquisition of a participation in a credit institution. The Commission might consider as the relevant third country either the country of origin of the ultimate parent or the country in which the majority of the business of the banking group is being conducted. *See* Bank Holding Company Act § 3(d), 12 U.S.C. § 1842(d) (1982).

33. Information Memo, *supra* note 18, art. 7(4)-(5), at 4-5.

credit institutions are excluded from geographic markets in a third country (e.g., from access to certain states of a federative country³⁴) or from certain product or service markets to which the third country credit institutions have access, lack of "effective market access" would be a case of discrimination.

However, it is still not clear whether U.S. banks meet the reciprocity requirement of Revised Article 7(4). EEC-banks may not have in the United States "competitive opportunities comparable" to those afforded by the EEC to EEC credit institution subsidiaries of U.S. banks. Although Revised Article 7 supposedly does not require a "mirror image" reciprocity as the original article 7 of the Second Directive may have done, reciprocity may still be denied. The right of an EEC credit institution subsidiary of a U.S. bank to establish freely branches and to do business throughout the EEC, granted by the Second Directive, must be measured against the restrictions on interstate banking prevailing in the United States.³⁵ If a U.S. bank attempts to set up or acquire a credit institution subsidiary in a Member State that permits its banks to underwrite corporate equity and debt securities or to deal in securities, the Commission might well reach the conclusion that EEC credit institutions do not have comparable competitive opportunities in the United States, because a bank from that Member State could not engage in such activities in the United States if it has a deposit-taking facility in the United States. This result is mandated by the Glass-Steagall Act, which has become a focal point of the reciprocity discussion.³⁶ But lack of reciprocity will now have a different consequence under Revised Article 7 than it had before.

In summary, Revised Article 7 will use two standards: 1) a reciprocity requirement will merely trigger the Commission's right to propose negotiations with a specific third country in question; and 2) a requirement for national treatment (or non-discrimination) will now decide whether the Commission may

34. "Many states either restrict or prohibit foreign bank branch or agency offices. Accordingly, in some states a banking subsidiary may be the only way in which a foreign bank can establish a full service banking office." Carr & More, *Developments in the Regulation of Foreign Bank Operations in the United States*, 1988 U. ILL. L. REV. 225, at 249.

35. See Gruson & Nikowitz, *supra* note 2, at 235-37.

36. See *id.* at 233-35; *supra* note 14 and accompanying text.

refuse access to the European banking market vis-à-vis a certain country. Thus, the revision of the Commission proposal for the Second Directive will mainly have two effects: First, the Commission's review procedure will no longer be on a case-by-case basis, but on a country-by-country basis; the Commission will no longer interfere with an individual authorization procedure before the competent authorities of a Member State. Second, the suspension of future authorizations³⁷ depends on a finding by the Commission that a specific country does not grant national treatment to EEC institutions; lack of reciprocity is no longer a basis for a denial of an application. This new approach will allow the Commission to defend against discriminations against EEC institutions abroad, while respecting different banking policies in third countries. It must be kept in mind, however, that even the language of Revised Article 7 is broad enough to allow the EEC to take aggressive positions against third-country discriminatory or non-reciprocal treatment of EEC credit institutions if the political climate in the EEC requires such approach. The revised version of the Second Directive is scheduled to be adopted by the Council this summer.

37. The decision of the Commission under Revised Article 7(5) will not have a retroactive effect ("new authorizations and acquisitions"). Information Memo, *supra* note 18, art. 7(5), at 5. Thus, credit institutions already authorized before the implementation of the Second Directive or before the Commission has taken the decision to refuse future authorizations with respect to the applicable third country, will benefit from the mutual recognition.