INSTITUTE FOR LAW AND FINANCE

THEODOR BAUMS, THIERRY BONNEAU, ANDRÉ PRÜM

THE ELECTRONIC EXCHANGE OF INFORMATION AND RESPECT FOR PRIVATE LIFE, BANKING SECRECY AND THE FREE INTERNAL MARKET

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Theodor Baums/ Thierry Bonneau/ André Prüm*

Abstract

The purpose of this essay is to assess the automatic exchange of information as described in EU Directive 2003/48 of 3 June 2003 on taxation of savings income in the form of interest payments with regard to the fundamental right of the individual to a private life, to banking secrecy and the freedoms on which the European internal market is based.

The assessment reveals the conflicts of interests and values involved in the holding by banks (particularly those offering private banking services) of increasingly extensive, detailed and intimate information about their clients and in the automatic processing of that information by ever more powerful and sophisticated systems.

Banking secrecy plays an essential role in protecting clients against the dangers which the disclosure of such information without their permission might produce. Banking secrecy exists not only in Luxembourg but also in many other European countries, and in Germany and France in particular it is not very different from the system applying in Luxembourg. While the French and German tax authorities do have some investigative powers not enjoyed by their Luxembourg counterparts, those powers are strictly circumscribed and cannot rely on the electronic exchange of information set out in EU Directive 2003/48/EC.

While banking secrecy is totally incompatible with the electronic exchange of information, the core question is whether the latter can be reconciled with the respect for private life. In a Europe that sets itself up as the cradle of human rights, the general and *en-masse* exchange of private information cannot provide adequate and sufficient guarantees that the information exchanged will not be misused. The amount of interference in private life is clearly out of proportion to the public interest involved and is contrary to

* Prof. Dr. *Theodor Baums*, ILF, University of Frankfurt/Main; Prof. *Thierry Bonneau*, Panthéon-Assas University (Paris 2); Prof. *André Prüm*, University of Luxembourg. – The paper is based on a study of the authors for a bankers´ association.

sub-section 2, article 8 of the European Convention for the Protection of Human Rights and Fundamental Freedoms and to articles 7 and 8 of the Charter of Fundamental Rights of the European Union.

Since the automatic exchange of information at least potentially risks restricting the free flow of capital among Member States and discouraging the use of transborder banking services, its compliance with the fundamental principles of the internal market also needs to be closely examined. The restrictions imposed by such exchange very probably go beyond the limits within which the free movement of capital and services is possible. The European Court of Justice has found that there is no proportionality if the measures supposedly undertaken in the general interest are actually based on a general presumption of tax evasion or tax fraud. However, it would be true to say that the ECJ does not always examine the tax restrictions placed on the free movement of capital particularly thoroughly to ensure that they are necessary or proportionate.

The economic effectiveness of the automatic exchange of information is far from being proved and involves significant cost to the banks providing the information and to the tax authorities using it. To date the system does not appear to have produced any significant new tax revenue nor does it prevent the continuing outflow of capital from Europe. Yet withholding at source, which respects individual and economic freedoms, does generate tax revenue that is cost-free to the State. Exchange of information on request in justified cases using the OECD Tax Convention on Income and Capital model does also fight tax fraud while at the same time providing citizens with the guarantees required to ensure their private lives are respected.

A combination of these two systems - withholding at source and exchange of information on request in justified cases - would create the proper balance between the public and private interest that the automatic exchange of information cannot provide.

A. Introduction

To ensure that the interest received by an individual in a Member State in which he is not resident for tax purposes is taxed in accordance with the law of the Member State in which he is resident, EU Directive of 3 June 2003 (Directive 2003/48 on taxation of savings income in the form of interest payments) envisages the automatic exchange of information between tax authorities in the Member States of the European Union. In the case of Belgium, Luxembourg and Austria however, the new system was replaced over a transitional period by withholding at source, the revenue being shared between the withholding Member State and the Member State in which the beneficiary of the interest is resident. The transitional period will end in the manner set out in the Directive.

The automatic exchange of information occurs automatically on an annual basis without any request by a Member State when specific details of individuals (their names, bank accounts and interest paid) is divulged. This is usually confidential information that is protected and cannot be disclosed. Confidential information cannot be divulged without the agreement of the individuals concerned. This leads to the question of whether the automatic exchange of information respects the right to a private life enshrined in the European Convention on Human Rights and protected by banking secrecy that the Member States recognise and protect. This is the question that we are addressing in the following as the transitional period is drawing to a close and before the automatic exchange of information becomes a general phenomenon.

This is a delicate matter since the automatic and general exchange of information to the tax authorities appears to have a solid basis in the public interest. We also believe that the same interest would certainly justify the lifting of banking secrecy if this protected only the interests of those bound by it. But the question is actually less about banking secrecy and more about respect for private life, which is a fundamental right of all European citizens. Information must not be disclosed in any way that causes unlawful and disproportionate harm to private life. Respect for private life must continue to form part of this debate. This fundamental right is as important for a democratic society to protect as those public interests that require the automatic and general disclosure of information. Those public interests must furthermore also be weighed against other public interests that such disclosure could harm (economic and social development as promoted in Europe through the single European market).

We do not believe that any interest or value (cf. C., below) can be left out of this discussion. So the question is how to address them, and since countries are obviously entitled to collect the taxes they impose on the basis of fiscal justice, the question is whether respect for private life and the freedoms

underlying the single European market are best protected through the exchange of information or by the withholding at source allowed under the Directive of 3 June 2003 (D., below). To answer this question we must first look at the context (cf. the following sub B.).

B. The context

The disclosure of information between authorities cannot be examined without considering the factual circumstances. We will therefore first consider the environment and then banking secrecy in particular.

I. General environment

The fact that governments want information on their citizens is not new. The recent banking and financial crisis has made this desire even keener, as the declarations made by the G20 in March 2009 show. And these were not empty words. The French banks, for example, undertook to make available to their parent companies information on transactions and operations in an area that led the country to be ranked one of the least co-operative (*Revue banque*, June 2009, page 6). Yet we must not confuse tax havens with regulatory havens. Regulatory havens have little or no regulation of transactions while tax havens offer more attractive fiscal regimes to the wealthy. Although attractive fiscal regimes did not cause the financial recession, lax regulation of transactions did contribute to it.

The renewed interest in information held by third parties comes at a time when some of them (banks, investment companies) are accumulating increasing quantities of data.

1. Bankers - professional information holders

The nature of banking means that banks also hold information on their clients (*Court of Luxembourg*, 24 April 1991, p. 28, 173 "by profession, bankers must hold confidential information on their clients and third parties") concerning their assets and other matters. This applies to all banks, including those offering private banking services.

All clients must provide their banks with huge amounts of information that touches on the most intimate aspects of their private lives. Their accounts show details not only of their assets but also of their standard of living, what they buy, where they go and generally on how they live. The asset management services they require of a private banker will often require them to disclose their most personal details since

without that information the banker will be quite simply unable to give them the professional advice and service they require.

The same applies to all clients, wealthy or otherwise. Since all payments and deposits involve bank money, bankers hold large amounts of information on their clients.

2. The increasing amount of information held by banks

The amount of information held by banks is growing. However this is not the banks' own choice: they do not want to know more and more about their clients. This is an obligation imposed on banks by government.

The trend is rising, as evidenced by EU Directive 2004/39 of 21 April 2004 (on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC) which requires clients to be classified into a number of categories and their financial positions to be assessed so that they can be offered the most suitable products and services. It is also evidenced in the anti-money laundering legislation that followed the Directive of 26 October 2005 (Directive 2005/60 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing as amended by Directive 2008/20 of 11 March 2008 as regards the implementing powers conferred on the Commission), which requires banks to collect information on their clients and their transactions and makes bank obligations dependent on their exposure to client risk. This has not however prevented ever more insidious interference, using the threat of primary money-laundering offences to spread well beyond its original anti-drug purpose to take in far less important offences.

The trend does have its justification: the client's own interests, the public interest or the interest of the financial system as a whole. However, it is not only banks that are holding increasing amounts of information about us: the number of CCTV cameras in public places is multiplying, on some forms of public transport (e.g the Paris public transport system with its Navigo card) individuals' comings and goings are recorded, and the number of files held on us is growing in general.

This is why legislation has been passed on the keeping of computer files. The French law on IT and freedom of 6 January 1978 (law 78-17 on IT, computer files and freedom) led the way, implementing the concept that the collection and use of personal data must be regulated and monitored. Those same principles now underlie the rules that apply Europe-wide (e.g. Directive 95/46/EC of 24 October 1995,

Directive 2002/58/EC of 12 July 2002, the Convention for the Protection of Individuals with regard to Automatic Processing of Personal Data, in Germany the *Bundesdatenschutzgesetz* (Federal Data Protection Act) of 14 January 2003 (*Bundesgesetzblatt* I, 66) and in Luxembourg the amended laws of 2 August 2002 and 30 May 2005).

II. Specific context

Banking secrecy is recognised and protected. It is based on the respect for private life and certain areas of public interest. It is not absolute and there are numerous exceptions to it, mainly in favour of public authorities authorised to exchange information.

1. Banking secrecy in Community and national law

Banking secrecy is not enshrined in any particular Community law but Community directives do take it into account: the Directive of 6 May 2009 (arts. 2 and 5 of Directive 2009/44 amending article 3 of Directive 2002/47/EC of 6 June 2002 on financial collateral arrangements) is just one example. The ECJ also recognises its existence (ECJ 10 December 2002, Weduwe, C-153/00). Banking secrecy is thus part of Community life, which is hardly surprising given that it is recognised and protected by the Member States.

Treated as a matter of public policy in France (E. Collomp, *Le secret bancaire*, French Cour de Cassation report 2004) and in Luxembourg (*Cour d'appel*, 2 April 1993, *Bull. Droit et Banque*, 2003, no. 34, p 52; *Cour d'appel*, 13 March 2002, *Bull. Droit et Banque*, 2002, no. 33, p 40; Cour de Cassation, 22 May 2003, Cour de Cassation, 18 March 2004, no. 2053: case law available on-line at www.codeplafi.lu under *secret bancaire*), banking secrecy is protected by law with penalties in the event of violation (art. L.511-33 and L.571-4 French Monetary and Financial Code; art. 226-13 French Criminal Code; art. 41 Luxembourg Financial Sector Act of 5 April 1993 as amended; art. 458 of the Luxembourg Criminal Code, Grand Ducal Order of 24 March 1989). In 2008 the French Parliament also passed law 2008-776 of 4 August 2008 modernising the economy (see Th. Bonneau, *Apports concernant les marchés financiers* in *Dr. sociétés*, November 2008, no. 232) and making investment companies subject to professional secrecy (article L 531-12 reproduces article L 511-33 of the Monetary and Financial Code) while recent order 2009-866 of 15 July 2009 on the provision of payment services also makes the personnel and management of paying agents subject to the same obligation (article L.522-19 Monetary and Financial Code resulting from article 12 of the order). In Germany banking secrecy is protected by a number of laws (cf. para. 1, sub-section 3, sentence 2 Federal Data Protection Act and section 30a of its implementing order) and is seen by the civil

courts as one of banks' primary duties to their clients (*Bundesgerichtshof*, *Neue Juristische Wochenschrift*, 2006, 830, 834).

In Luxembourg, banking secrecy is an obligation discharged by achievement of a result (see the above case law); and it is vigorously protected by the French courts. In civil law, professional secrecy is a valid reason for non-disclosure, even if the bank incurs liability by refusing to do so (Cour de Cassation, chambre commerciale, 13 November 2003, *Banque et droit* no. 94, March/April 2004, comment by Th. Bonneau; JCP 2004, ed. E, 736, no. 6, comment J Stoufflet; *Rev dr bancaire et financier* no. 4, July/August 2004, comment by F-J Crédot and Y Gérard; Cour de Cassation, chambre commerciale, 25 January 2005, *Bull civ*., IV, no. 13, p. 12; *Banque et droit* no. 101, May/June 2005, 70, comment by Th. Bonneau; D. 2005, *act. jurisp.* 485, comment by V. Avena-Robardet; *Rev dr bancaire et financier* no. 2, March/April 2005, 12, comment by F-J Crédot and Y Gérard; *Rev. trim. dr. com,* 2005, 395, comment by D Legeais; JCP 2005, ed. E, 1676, no. 6, comment by AS; Cour de Cassation, chambre commerciale, 23 January 2007, *Banque et droit* no. 113, May/June 2007, 38, comment by Th. Bonneau).

2. The private and public interests protected by banking secrecy

Banking secrecy protects both public and private interests.

The French courts place the emphasis on the protection of private interests (Cour de Cassation, chambre commerciale, 11 April 1995, *Bull. civ*. IV, no. 121, p. 197; *Rev. dr. bancaire et bourse*, no. 50, July/August 1995, 145, comment by F-J Crédot and Y Gérard; *Rev. trim. dr. com*, 1995, 635, comment by M. Cabrillac; *Quotidien juridique* no. 51, 27 June 1995, 4; JCP 1996, ed. E, I. 525, no. 6 comment by Ch. Gavalda and J Stoufflet; D 1996, J. 573, comment by Matsopoulou; see Th. Bonneau *Communication de pièces et secret bancaire* (on the order handed down by the commercial division of the Cour de Cassation on 11 April 1995), *Rev. dr. bancaire et bourse* no. 49, May/June 1994, 94) on the basis that banking secrecy protects clients. We support this view on the grounds that banking secrecy is first and foremost an expression of the duty of loyalty and that once it is enshrined in law, "it becomes a personal right within society like any other: respect of private life, the family, the home and of correspondence" (M. Contamine-Raynaud, *Le secret bancaire et le contrôle de l'Etat sur les opérations de change et sur leurs effets délictuels*, RIDC 1994, p. 487). The same view is taken in Germany where the courts and legal writers see banking secrecy mainly as a way of protecting personal freedom (*Bundesgerichtshof, Neue Juristische Wochenscrift* 2006, 830, 834; Canaris in Staub, *Handelsgesetzbuch*, 4th edition, 1988, *Bankvertragsrecht* at 41).

But banking secrecy does not protect only private interests. It also protects public interests (Garabiol, previous paragraph) such as democracy and confidence (A. Teissier, *Le secret professionnel du banquier*, preface by G Di Marino, Presses universitaires d'Aix-Marseille, 1999, p. 265) and the economy since banking secrecy is "a political economic tool in that it can be used to attract capital to, or to retain it within, a country" (Teissier, ibid, p. 255). At the European level, banking secrecy as currently protected within a number of Member States certainly promotes the free movement of capital within the European Union. At the same time it encourages the free provision of services by the banks to clients in other Member States, thus contributing to the ever deeper integration of the single market (see above). These public interests are not overlooked, as demonstrated by the positions adopted by the OCBF (French Bank Co-ordination Office) (OCBF, *Secret bancaire*, in *Bulletin d'information* 12, April 2000) and by the Luxembourg financial supervisory authority (CSSF) whose committee of lawyers pointed out in a study published 1 March 2004 (CSSF 2004 annual report, page 196) that banking secrecy does not just protect the private life of clients but also the "authority of the profession and the trust relationship between the holders of the secrets and those protected". The committee concludes that a client cannot give his banker general and general release from the duty of secrecy without compromising "the general social interest" that the banker is also bound to protect.

3. Disclosure of information

In a very large number of countries banking secrecy is a relative concept with exceptions that allow the disclosure of information to, for example, the criminal prosecution authorities (e.g. article L.511-33 sub-section 2 of the French Monetary and Financial Code and paras. 160ff. of the German Code of Criminal Procedure). In some cases disclosure is allowed to authorities such as the French *Commission bancaire* (see above) or to the domestic and foreign financial supervisory authorities (article 41(3) of the Luxembourg law of 5 April 1993 or para. 24c of the German Banking Supervisory Act).

Exchanges of information between States have been organised at Community level since the Directive of 3 June 2003 allowing the automatic exchange of information breaks with the Directive of 19 December 1977 (Directive 77/799 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation as amended by Directive 2004/106 of 16 November 2004) in that the Directive of 3 June 2003 allows only the automatic exchange of information, while the 19 December 1977 Directive creates three types of exchange: on request (art. 2), automatic (art. 3), and voluntary (art. 4). A fundamental difference is that exchange on request implements the principle but cannot be made without a specific reason. It is a break also because automatic exchange is limited to specific cases and must be ordered after a consultation procedure, while voluntary exchanges, which are not subject to prior request,

can only occur in specific, generally unusual, circumstances. Finally, it is a break because the 19 December 1977 Directive sets limits that allow Member States to refuse to disclose information (art. 8). The Directive of 3 June 2003 does not diverge only from its 1977 predecessor, it also diverges from many other directives and in particular from the 14 June 2006 Banking Directive (Directive 2006/48 relating to the taking up and pursuit of the business of credit institutions) which allows the exchange of information on request between Member State authorities (art. 132).

The Directive of 3 June 2003 also runs contrary to article 26 of the OECD Tax Convention on Income and Capital which states that "countries are not at liberty to engage in 'fishing expeditions' or to request information that is unlikely to be relevant to the tax affairs of a given taxpayer. In formulating their requests, the requesting state should demonstrate the foreseeable relevance of the requested information. In addition, the requesting state should also have pursued all domestic means to access the requested information except those that would give rise to disproportionate difficulties" (OECD website, Article 26 of the OECD Model Tax Convention on Income and Capital).

This view is shared by a number of Member States such as France and Germany.

In France, exchanges of information between French financial authorities or with their foreign counterparts are on-request only (art. L.631-1 and L.631-2 Monetary and Financial Code; see also the charter between the *Commission de contrôle des assurances* and the *Commission bancaire* on co-operation in the control and exchange of information (arts. 12 and 13), *Bull. officiel de la Banque de France* no. 35, November 2001, 27; the co-ordination agreement between the *Commission bancaire* and the *Commission de contrôle des assurances, des mutuelles et institutions de prévoyance* on supplementary monitoring of financial conglomerates, *Bull. officiel de la Banque de France* no. 86 February 2006, 21; the co-operation agreement between the *Commission bancaire* and the National Bank of Croatia on banking supervision (art. 9), *Bull. officiel du CECEI et de la Commission bancaire* no. 10, December 2008, 6; the OIVC multilateral agreement on consultation, co-operation and the exchange of information (art. 8), *Bull. mens. COB* no. 383, October 2003, 223. See also the agreements signed by the *Commission bancaire* and the AMF quoted by Th. Bonneau in *Droit bancaire*, 7th edition, Montchrestien, no. 158-2 and note 151 by Th. Bonneau and F. Drummond, *Droit des marchés financiers*, 2nd edition, 2005, *Economica*, no. 1027 and page notes). Information can be exchanged voluntarily but in such cases and as many Community and European regulations have made it clear, it cannot be general, it must be justified, and it has to concern specific items of information (see articles 18 and 19 of the co-ordination agreement between the *Commission bancaire* and the *Commission de contrôle des assurances, des mutuelles et institutions de prévoyance* on supplementary monitoring of financial conglomerates; article L.632-6 of the Financial and Monetary Code).

The German Federal Financial Services Authority (BaFin) can also access bank details (bank account master data: name of account holder etc.) but does not have access to details of account transactions (section 24c of the Banking Supervisory Act). The fact that BaFin has direct access to these databases does not however mean that it can use the facility at its own discretion. On 13 June 2007 the Bundesverfassungsgericht (Federal Constitutional Court) ruled that BaFin cannot access the database without concrete, legitimate reason ("Under the terms of the regulation, accounts can be accessed only in the event of an actual *Ermittlungsverfahren* [judicial inquiry] or request for legal assistance that meets all legal requirements"; item 109) (http://www.bverfg.de/entscheidungen(rs20070613_1bvr15505.html).

There are differences within Europe as regards the ability of fiscal authorities to obtain information from banks.

The German tax authorities cannot request information from a bank unless they have been unable to obtain that information directly from the taxpayer ("unless a request for information from the taxpayer does not obtain the desired effect or is without effect", para. 93, sub-sections 1, 7, 8 and para. 93b of the Tax Code (Abgabenordnung) provided that they have concrete evidence that leads them to believe that the taxpayer's tax returns are incomplete or untruthful ("There must be sufficient basis for the request for information; fishing expeditions and computer surveillance are not allowed" – paras. 30a(2) and 93(1) Tax Code; see also the above 13 June 2007 decision of the Federal Constitutional Court, no. 111ff). In an internal circular (*Anwendungserlass*) the tax authorities recognised that they cannot blindly take action without good reason (AEAO, "*Pursuant to section 93(7) AO, access to accounts for fiscal reasons is therefore only allowed for specific reasons.* It must be necessary for the specific case concerned and must relate to one specific person (no. 2.3 AEAO). *Before the account is accessed, the person concerned must be given the opportunity to provide the information him/herself unless this would compromise the purpose of the disclosure*" (no. 2.6 AEAO); see also marginal 37 of BVerfG, cited above).

In France, the opening and closing of accounts must be reported to FICOBA (the register held by the tax office that records bank accounts) (art. 1649-A, General Tax Code; F Bordas, *Devoirs professionnels des établissements de crédit, Secret bancaire*, vol. 141, *Juris-classeur, Banque-Crédit-Bourse*, special 43). Although the French tax authorities can obtain a large number of documents (articles L.83 and L.85 of the Code of Fiscal Procedure), they can only investigate "*specific matters; they cannot carry out general investigations*". An order of 18 March 1988 sets out when they can exercise their right of investigation and states that "*demands for very small amounts must be eliminated and the right to disclosure may not be exercised unless the taxpayer and bank client*

has himself failed to provide that information to the authorities" (Bordas, *Devoirs professionnels des établissements de crédit, secret bancaire*, previous article, no. 50).

The Luxembourg tax authorities have no right at all to investigate direct tax matters. The Grand Ducal regulation of 24 March 1989 makes this perfectly clear: *"Tax authorities may not require banks to disclose items of information on their clients unless allowed by the law of 28 January 1948 on the due collection of registration and succession tax" (article 1).*

Beyond these differences, none of these three countries allows the automatic and voluntary disclosure of information to the tax authorities that is allowed under the 3 June 2003 Directive. Exchange of information with the tax or any other authorities is in all cases subject to specific reason.

C. The values and interests in conflict

I. Public interests and the principles of individual and economic freedom

The exchanges of information and systems of mutual assistance introduced by Directives 77/799/EEC and 2003/48/EC are based on a clear dual public interest: the collection by the Member States of the taxes they have imposed and fiscal justice among taxpayers. Protecting that interest means setting up effective fiscal measures for combating tax fraud, imperatives that the ECJ recognises as "*reasons of imperative general interest*" (see ECJ, 18 December 2007, A, C-101/05, ECR 1-11531, item 555, and ECJ, 11 October 2007, ELISA, C-451/05, ECR 1-8251, point 81) to which the EC Treaty also refers (art. 58.1.b). Whatever the importance of the interest in question, it must be set against other fundamental rights.

Article 6, sub-sections 1 and 2 of the Treaty of the European Union state that:

> *"The Union is founded on the principles of liberty, democracy, respect for human rights and fundamental freedoms, and the rule of law, principles which are common to the Member States.*
>
> *The Union respects the fundamental rights as warranted by the European convention on the safeguard of human rights and fundamental liberties signed in Rome on 4 November 1950 and as they result from constitutional traditions common to Member States as the general principles of Community law."*

We must therefore consider firstly whether the safeguards provided for the public interest comply with the "*principles of liberty, democracy, respect for human rights and fundamental freedoms and the rule of law*", the respect for private life being the most critical aspect of them.

Creating the basis for secondary legislation, this form of public interest must also be weighed against the objectives of the European Union and in particular its aim "*to promote economic and social progress ... and to achieve balanced and sustainable development, in particular through the creation of an area without internal frontiers*" (article 2, Treaty on European Union). In other words, we must see to what extent the automatic and general exchange of information would be compatible with the freedoms underpinning the single market and the free movement of capital and services in particular.

Do we also need to measure the legality of such a system directly against the banking secrecy yardstick, i.e. after we have already taken account of the respect for private life that is its prime basis? Such a test does not seem necessary unless banking secrecy is a stand-alone value requiring separate protection or, in Community law terms, it is a general principle of Community law.

A comparison with the professional secrecy imposed on lawyers shows that this is not the case although that form of secrecy is of importance. The ECJ considers it only within the context of the fundamental rights it must protect and more specifically of the right of the individual to a fair trial (ECJ, 26 June 2007, C-305/05, point 29. For procedural reasons only the ECJ ignored the second aspect, respect for private life, which was highlighted by the Advocate General, point 18 of the above order). Since lawyers must under certain circumstances disclose suspicions of money laundering, their professional duty of secrecy is not recognised as a general overriding principle. Only fundamental rights (in this case the right to a fair trial) are, in the ECJ's view, values that can be balanced against the fight against money laundering and that can, in certain circumstances, render the limitation of professional secrecy unlawful (cf. the conclusions of Advocate General Poiares Maduro in C-305/05, no. 38).

The same conclusion applies to banking secrecy. Now subject to the automatic exchange of information, banking secrecy is not of itself an argument that can prevail over the public interest on which such exchanges are based. However, its underlying principles cannot be ignored.

There must be a proper balance between these public interests and the principles of individual freedom (shielded by the respect for private life and personal data protection) and of economic freedom, the latter forming the basis for the single market. When establishing that balance, due consideration must be given to whether it is imperative to sacrifice the private to the public interest or whether that sacrifice is out of proportion to the objective pursued. Both criteria apply when resolving conflicts of values and interests protected by the European Convention on the Safeguard of Human Rights and Fundamental Liberties and also to the main thinking behind Community law as this is translated into article 5 EC.

II. Respect for private life and personal data protection

1. The right to respect for private life and personal data protection

When opening a bank account, clients must first provide the bank with details of their identity, address, marital status and job. As we have pointed out, throughout the business relationship the bank will collect a lot of other personal information about the client. Anti-money laundering laws require banks actively to collect information in areas that are increasing in scope along with the legislation itself, as demonstrated by the Directive of 26 October 2005. The 21 April 2004 MIFID Directive similarly requires banks to collect all the data needed to assess their clients' assets and to classify them by investment profile.

Private banks, from which clients expect professional advice and assistance in the management of all or part of their assets, will of course have even greater information on their clients that will often be of an extremely intimate nature.

Fundamental liberties include respect for private life and the protection of that life as regards the processing and circulation of personal data. The rights are specifically enshrined in the 4 November 1950 European Convention on the Safeguard of Human Rights and Fundamental Liberties, whose article 8(1) states that:

> *"1. Everyone has the right to respect for his private and family life, his home and his correspondence".*

In a dynamic interpretation of this provision, the European Court of Human Rights has made the respect for private life a concrete and effective reality (ECHR, 9 October 1979, Airey in F. Sudre, J-P Margénaud, J Andriantsimbazovina, A. Gouttenoire, M. Levinet, *Les Grands arrêts de la Cour européenne des droits de l'homme*, PUF, Thémis, 2nd. ed., 2004, GACEDH no. 2). It has also not hesitated to extend the scope of protection to include the individual's social relations (ECHR, 16 Dec. 1992, Niemetz v Allemagne, *Les Grands arrêts de la Cour européenne des droits de l'homme* no. 40 in which the ECHR held that the harm caused to the professional secrecy binding lawyers was out of proportion to the legitimate aim pursued). ECHR case law evidences a particular sensitivity to the saving and/or disclosure of personal data that could lead to the secret surveillance of citizens with the "*risk of enfeebling, if not destroying democracy on the grounds that it is being defended*" (ECHR, 6 Sep. 1978, Klass v. Germany, A.29 *ibid*, no. 18; ECHR, 5 May 2000, Rotaru v Romania).

The ECHR holds that personal data, which it sees as being of "*fundamental importance*" to the enjoyment of the right to respect for private life, cannot be disclosed without the permission of the interested party unless it is in the "*fundamental public interest*" and is accompanied by proper and sufficient guarantees, and by judicial control in particular, that the data will not be misused (ECHR, Rotaru *ibid*; ECHR, 25 Feb. 1997, Z v Finland; JCP G 1998, I, 107, no. 35, chron, F Sudre).

These principles apply in full within the Community. The European Court of Justice has made specific reference to the Convention and has adopted the ECHR interpretation of article 8 (ECJ, 26 June 1980, 136/79, National Panasonic v Commission; ECJ 1980, ECR 2033, pt. 17). The duty to protect personal data underlies Directives 95/46/EC of 24 October 1995 and 2002/58/EC of 12 July 2002, which the ECJ has also made strictly subject to the Convention (ECJ, 20 May 2003, C-465/00, C-138/01, Rechnungshof, Österreichischer Fundfunk: RTDH 2004, p. 724, comments by C Maubernard). In the view of the ECJ, "*fundamental rights form an integral part of the general legal principles protected by the Court of Justice*" (ECJ, 17 December 1970, Internationale Handelsgesellschaft, 11/70: ECJ 1970, ECR 1125). If "*the protection of these rights through the basis of constitutional traditions common to all Member States must be provided through the Community's organisations and aims*", they cannot be superseded by secondary law.

The European Charter of Fundamental Rights restates these principles: article 7 provides that "*Everyone has the right to respect for his or her private and family life, home and communications*" and article 8 that "*Everyone has the right to the protection of personal data concerning him or her*" anticipating the wording of the European Constitution.

2. Disproportionate harm to private life

In order to protect the individual against arbitrary interference in his private life by public authorities, article 8(2) of the European Convention on the Safeguard of Human Rights and Fundamental Liberties provides that:

> "*There shall be no interference by a public authority with the exercise of this right except such as is in accordance with the law and is necessary in a democratic society in the interests of national security, public safety or the economic well-being of the country, for the prevention of disorder or crime, for the protection of health or morals, or for the protection of the rights and freedoms of others*".

Combating capital flight and tax evasion are certainly legitimate aims under this rule, since their purpose is to ensure "*the economic well-being of the country*" but we have yet to see whether, in the light of this objective,

the automatic exchange of information allowed under Directive 2003/48/EC is a necessity and not disproportionate interference.

Necessity must be demonstrated at a practical, not simply theoretical, level. The ECJ does not for example allow Member States to process the personal data of citizens who are not their own nationals in order to combat crime (ECJ, 16 December 2008, Huber v Germany, C-524/06).

When considering the proportionate nature of such measures, the ECJ, like the ECHR, will look at whether "*a proper balance*" is maintained between the general interest and the interests of the individual (e.g. ECHR, Klass, 6 September 1978, A.28, section 59 on the secret surveillance of citizens' correspondence and telecommunications in order to fight against terrorism). The need to achieve a balance between the lawful objective and the means used to achieve it are "*at the heart of the control of the margin the European courts allow the Member States when applying national restrictions to protected rights*" (*JCI Europe*, file 6525, by F Sudre).

One interesting precedent is worthy of note: a French anti-fraud law that gave customs officers the right to enter homes and seize documents. In a series of three judgments made in one day (Miaihe v France, 25 February 1993, app. 10588/83; Funke v France, 25 February 1993, app. 12661/87, and Cremieux v France, 25 February 1993, app. 11471/85) the ECHR ruled firstly that such legislation and its implementation must provide "*proper and sufficient guarantees against misuse*". Holding that there had been significant interference, the Court said that there are no such guarantees if seizures are "*en-masse and especially general*" and that there had been a breach of article 8. Is not the automatic exchange of information when there is no real risk that the taxpayer concerned will not meet his fiscal obligations totally "*general*" and "*en-masse*"? Using this system to ensure that interest on savings is properly taxed is a particularly serious violation of the respect for private life, given that the law does not allow its use for other equally important public imperatives, such as the stability of the financial system.

As one writer has said, "*the scale of values depends on how we view life within society. It will be different in a totalitarian State from in a democratic State since human rights and human freedoms will not be viewed in the same way, because the importance placed on professional secrecy essentially depends on the importance society places on the individual and the protection of his personality*". (P Lambert, *Le secret professionel*, Nemesis, Brussels, 1985, p. 37).

We believe it is at least very debatable in a Europe setting itself up as the cradle of fundamental human rights whether the interference in private life caused by the automatic exchange of information as allowed under Directive 2003/48/EC complies with the principle of proportionality. Claiming that it does (whereases 10 and 26 without any grounds) is theory rather than practice and is unconvincing.

III. The freedoms underlying the single market

It may appear surprising to wish to check whether a Directive meets the principles of freedom underlying the single market. Do not these principles apply only to the Member States, prohibiting them from raising barriers within the single market?

This is certainly an interesting question given that the automatic exchange of information would do away with the withholding at source still allowed under Directive 2003/48/EC. The argument that the automatic exchange of information might prejudice the free movement of capital and services is of relevance here (article 5, TUE) and leads to the following examination.

1. The restrictive nature of the automatic exchange of information

(a) Article 49 EC, introducing the freedom to provide services (FPS) prohibits any action that would render the provision of services between Member States more difficult than the provision of services within a single Member State (ECJ 28 April 1998, Safir, C-118/96, ECR I-1897, point 23,; ECJ 4 March 2004, Commission v France, C-334/02, ECR I-2229, point 23 and ECJ, 11 September 2007, Commission v Germany, C-318/05, ECR I-6957, point 81). The ECJ has several time applied FPS to the financial sector (ECJ, 10 May 1995, Alpine Investments BV, C-384/93; ECJ, 14 November 1995, Svensson, C-484/93 and ECJ, 3 October 2006, Fidum Finanz, C-452/04).

In a very recent case on a national law introduced to fight tax fraud by persons investing some of their savings with banks in another Member State, the ECJ decided that applying to assets held outside the Member State of residence rules different from those applying to assets held with a local bank could "*make it less attractive for taxpayers to transfer their assets to another Member State in order to benefit from the financial services offered there than to keep those assets and obtain financial services in the Netherlands*", their Member State of residence (ECJ, 11 June 2009, C-155/08 and C-157/08, point 39). The Court concluded that the legislation "*constitutes a restriction on the free provision of services and on the free movement of capital and is prohibited in principle by articles 49 EC and 56 EC*" (*ibid*, point 40).

It seems indisputable that introducing a solution under which banks that manage non-resident savings must set up a system for the automatic exchange information will make it more difficult for them to offer transborder services. They will firstly come up against the natural resistance European clients have to such systems (for restrictions and capital flows, see below). Managing the system will also generate a cost

that will not apply to asset management for resident clients. The result will be that transborder business will be subject to constraints that are contrary to FPS and whose cost will rise the greater the bank's percentage of European asset management clients. Banks in small countries like Luxembourg will be much harder hit than banks in countries with a large domestic market.

(b) Investment by European citizens of some of their savings with banks outside the Member State in which they are resident produces capital flows within the meaning of articles 56ff EC in line with the principle of the free movement of capital. Directive 2003/48/EC aims to ensure that interest on savings income is taxed in the beneficiary's country of residence under the rules that apply there. The Directive may therefore impact the movement of capital within the European Union, as its reference to articles 56-60 of the EC Treaty makes clear. It is generally agreed that the prohibition contained in article 56 of the EC Treaty applies only to national laws and regulations passed by a Member State but as we have already commented, the test of whether the automatic exchange of information justifiably restricts these movements is simply a proposal being made here.

Well-established ECJ case law extends the prohibition to indirect restrictions that do not stop financial transfers or associated legal transactions but can be dissuasive, particularly by making capital movements more expensive. Simply the risk of such dissuasion is held to be sufficient (ECJ, 16 March 1999, Manfred Trummer and Peter Mayer, C-222/97; ECR I-7587, point 18). Tax rules are continuing to expand this case law, in which the ECJ has kept an open mind on what constitutes a prohibited restriction.

In the above 11 June 2009 judgment, the ECJ held that a law passed by a Member State setting a seven-year recovery period for assets held outside its borders and at the same time imposing fraud penalties (if applicable) over that entire period time restricted the free movement of capital. It decided that the law in question materially reduced the time in which a taxpayer can benefit from the legal security he can expect from a limitation of the recovery period.

A similar approach would not be inappropriate to the automatic exchange of information on savings held in a bank outside the depositor's Member State of residence. Whatever the circumstances and reasons causing people to wish to have part of their assets managed in another Member State, this information system could cause them to draw back because it creates a circle of information whose size and consequences they cannot understand. This dissuasive effect is especially clear in that Europe as a whole places no similar constraint on assets invested in banks in the investor's country of residence and the restriction itself is not imposed by most Member States.

To conclude, the automatic exchange of information restricts the free provision of services and the free movement of capital. In the following we will consider whether this restriction, created by a Community Directive, is justified by the exceptions allowed under the EC Treaty or by reasons of imperative general interest.

2. Reasons for restricting the freedom to provide services and the free movement of capital

The EC Treaty specifically allows certain restrictions on the movement of capital. It allows Member States to "*apply the relevant provisions of their tax law which distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested*" and to "*take all requisite measures to prevent infringements of national law and regulations, in particular in the field of taxation*" (art. 58(1)(a) and (b), EC Treaty).

This must be set against the need to combat tax fraud and to ensure that fiscal controls are effective. The ECJ considers these "*reasons of imperative general interest*" able to restrict the freedoms of movement enshrined in the EC Treaty (ECJ, 18 December 2007, A, C-101/05, ECR I-11531 point 555 and ECJ, 11 October 2007, ELISA, C-451/05, ECR I-8251, point 81).

However this does not mean that the restriction can be based on a general presumption of tax evasion or tax fraud (ECJ, 17 July 1997, Leur-Bloem, C-28/95, ECR I-4161, point 44). This has led to the invalidation of a Belgian law preventing the purchase by Belgian residents of foreign debt securities (ECJ, 26 September 2000, Commission v Belgium, C-478/98, ECR I-7587, point 45).

But is this not the justification also used to support the general and automatic exchange of information?

A rather subtler approach appears to have been taken in the 11 June 2009 judgment. When considering the disputed Dutch law (extended recovery period and extension of the period of time to which any fine will apply), the Court distinguished between taxable items that are concealed from the tax authorities in the country of taxation so that there is no evidence of the existence of the items that would enable the authorities to begin an investigation, and situations in which the Member State imposing the restriction does have evidence that such items exist in another Member State and is therefore able to begin an investigation. In this particular case, the Court decided that the former situation applied and that "*in these circumstances, subjecting taxable items concealed from the tax authorities to a twelve-year extended recovery period does not go beyond what is necessary to ensure the efficacy of fiscal controls and to combat tax fraud*" (point 70). It also observed that since the aim was not to enable the authorities in the Member State concerned to obtain information

from the Member State in which the savings were held (Luxembourg) "*it is not ... necessary to know if banking secrecy applies in the latter*" (point 68).

The Court's reasoning is not the simplest to follow and is essentially based on the fact that since there was no evidence that a Dutch taxpayer held any financial assets in a foreign bank, the recovery period could have been extended to give the Dutch authorities more time to obtain from the Member State in which the bank was located information that would allow them to start legal action (points 66 and 67). Consequently the extended period was not too long for the request for information. It only means that "*a longer period was allowed during which discovery of taxable items could have given rise to recovery so long as the investigation that followed the discovery led to recovery before the period ended*" (point 67). The fact that the twelve-year recovery period was set "*on the basis of the time allowed for tax fraud procedures*" was enough for the Court to consider it not disproportionately long (point 69). In other words, the Netherlands cannot automatically obtain from Luxembourg (or Germany) information on accounts held by taxpayers who are subject to its laws allowing restrictions on the free movement of capital and services.

We believe this is rather too succinct a manner of demonstrating the need to apply restrictions in the face of an alleged imperative reason and its proportionality. If the recovery period can be extended only in one simple eventuality (the Dutch tax authorities by chance happened to discover the existence of items that no-one other than the taxpayer who concealed them need disclose) the need, let alone the usefulness, of this measure must remain dubious.

The inconvenience caused to taxpayers in terms of legal security is on the other hand far from negligible, meaning that the restriction does not appear to be proportionate. It is regrettable that the case did not lead to any written conclusions by the Advocate General but this may be an indication of the low importance placed on it by the Court.

So what should we conclude from our consideration of whether the restriction on the free movement of capital and services imposed by the automatic and general exchange of information is justified?

The system appears to be based on the assumption that European taxpayers make dishonest declarations to the tax authorities about the interest they receive on their savings deposited with banks in Member States outside their country of residence. Standard ECJ case law maintains that restrictions cannot be based on such assumptions. Yet the Court now seems to take the view that the introduction of automatic exchange of information as provided in Directive 2003/48/EC would offer a very effective way of

combating tax fraud, and from here to declaring that the system does not go beyond its stated objective is but one small step.

To conclude, in the light of fundamental human rights and of the specific harm that would be caused to private life, the automatic exchange of information should not be allowed. Although there is no evidence that the system is compatible with the freedoms inherent in the single market, its use might be justified by the imperative need to combat tax fraud and to ensure that fiscal controls are effective, an area in which the ECJ does not always apply very thorough tests of proportionality..

D. The proper balance between the public interest and respect for private life

The serious harm an automatic information system can do to the respect for private life means that we must consider whether the purpose of Directive 2003/48/EC could not be obtained by any other less invasive but possibly equally effective methods.

Two solutions immediately spring to mind: the exchange of information on request as provided under both Directive 77/799/EEC and the OECD Tax Convention on Income and Capital (article 26), and withholding at source in the country in which the savings are held, most of which revenue would be paid to the taxpayer's Member State of residence, a method that Directive 2003/48/EC allows as a (temporary) alternative to the automatic exchange of information.

The acceptability of the latter solution in terms of respect for private life must be considered in the light of the effectiveness of other, far more respectful, systems. In other words, the harm done to respect for private life by a system of blind automatic exchange of information is made all the more unacceptable by the fact that (a) there is no clear evidence that it is more effective in taxing interest income and (b) the current system of exchange on request, which does respect private life, is preferable.

I. The automatic exchange of information is of doubtful economic benefit

There is little proof that the automatic exchange of information is better than withholding at source, indeed quite the opposite is true (see reports and documents at http://ec.europa.eu/taxation_customs/taxation/personal_tax/savings_tax/savings_directive_review/index_en.htm.

In a report to the Council of 15 September 2008 ([SEC (2008) 2420] p. 4) the European Commission seeks to be reassuring when it declares that "*The Directive has proven effective within the limits set by its scope. It has*

also had indirect, non measurable, positive results in enhancing taxpayers' compliance with their obligations to declare interest income."
(http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/savings_directive_review/COM(2008)552_en.pdf).

We have searched in vain for evidence to support this statement in the report itself and in the impact study produced for the amendment of the Directive and published 13 November 2008 [SEC (2008) 2767]. In this, the Commission admits that it has been unable to obtain the data needed to carry out a serious assessment of the Directive and that data is lacking on the exchange of information in particular. It is therefore at present impossible to obtain any clear understanding of how much tax revenue the automatic exchange of information generates or even how the tax authorities use the information they receive. It therefore cannot be ruled out that such exchanges will have made an only minor contribution to the Directive's ultimate aim of "*bringing about effective taxation of interest payments in the beneficial owner's Member State*" (Directive 2003/48/EC, whereas 14).

That exchange has also given rise to expense is certain. The details provided by the Commission are incomplete here too (point 2.3, Impact Report) but the empirical study conducted by the European Policy Forum under Graham Mather and Keith Boyfield (Graham Mather & Keith Boyfield, *Challenges Facing the EU Savings Tax*, 2008) is more instructive. A huge survey of 1243 EU and Swiss banks has shown that compliance with the Directive has cost them €753 million to set up, plus €693 million each year to run. The writers estimate that extending the scope of the Directive as the Commission wishes would double the cost.

The Commission is also for the moment silent about whether the automatic exchange of information has led to a flight of capital to third countries where they will be beyond the reach of all European tax.

All this sets one thinking, particularly since withholding at source has no equal in terms of economic effectiveness. Not requiring the banks (paying agents) to set up complex information disclosure systems, it also ensures the efficient collection of tax on all applicable revenues. Since the system is managed directly by the banks, Member States enjoy the fiscal benefit at absolutely no cost to themselves. Could this be the reason why the vast majority of Member States tax savings income by withholding at source? In other words, the Member States do not consider the solution preferred by the Directive effective enough to be used to tax savings held within their own national boundaries. So how can it be effective to tax savings held in a bank in another Member State?

II. The security provided by withholding at source and/or exchange of information on request

Withholding at source implies no threat to private life. This is because the tax is collected in the country in which the savings revenue is transparently generated so that there is no need for the transfer of account holder details to the country of residence. Withholding not only protects the private lives of individuals but also promotes transborder transactions within the EU and consequently the free movement of capital and professional services. The automatic exchange of information creates indirect barriers to these freedoms. By enabling individuals to benefit from differing tax systems, withholding at source prevents the massive outflow of capital from Europe.

Exchange of information on request also respects private life. Requests are subject to conditions, compliance with which can be examined by the courts on a case-by-case basis. Requests for information can be examined in administrative procedures subject to appeal. By contrast, the automatic exchange of information offers no such guarantees and are not subject to any *a priori* control, while *ex-post* control is little more than a fiction. Once the information has been disclosed, the harm has essentially been done. It is extremely hard to prevent misuse of such a system that itself is very likely to cause disproportionate harm to private life.

The two systems can be implemented independently of each other. It is however true that withholding at source cannot prevent fraud that is unconnected with the withholding system or that is caused by a fraudulent transaction. But since this type of fraud is rare and cannot be presumed, it does not of itself justify the introduction of the automatic exchange of information but could justify a combination of withholding at source and exchange upon request.

E. Conclusion

Respect for private life does not prevent fiscal justice, which can easily be assured by withholding at source and payment of the tax to the country of residence of the interest beneficiary. It is true that the amount of the withholding may seem insufficient to some Member States but is that sufficient reason to generalise a system for exchanging information that causes material harm to the private life of Europeans? We do not believe it does, because Member States can deal with fiscal disparities before they occur. Furthermore, at a time when the desire is for Europeans to be able to carry out transactions freely across Europe, whatever the place of execution might be, is it reasonable to allow countries of residence to track those transactions wherever they go? Economic freedom must join the right to a private life and enjoy the same respect at all times.

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Institute for Law and Finance

Prof. Dr. Theodor Baums
Prof. Dr. Andreas Cahn

Institute for Law and Finance

im House of Finance der Goethe-Universität Frankfurt

Campus Westend – Grüneburgplatz 1

D-60323 Frankfurt am Main

Tel: +49 (0)69 / 798-33753

Fax: +49 (0)69 / 798-33929

www.ilf-frankfurt.de

INSTITUTE FOR LAW AND FINANCE

GOETHE-UNIVERSITÄT FRANKFURT AM MAIN