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FROM HARMONIZATION TO INTEGRATION IN THE EUROPEAN SECURITIES MARKETS

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1. Fragmentation versus integration

At present the state of integration of the securities markets within the European Economic Community (EEC) can be characterized as follows: traditionally strong centrifugal forces that formerly prevented integration still exist; yet these disintegrating forces are opposed by several centripetal forces, which although not a complete counterbalance, nonetheless encourage the integration of the securities markets.

1.1. The forces of disintegration: fragmented national securities markets

Each of the Member States has a functioning securities market. These securities markets differ greatly from one another in that each has its own distinct organizational structure. Moreover, some of the national markets are further divided into submarkets, one or two of which play a leading role. Furthermore, since some Member States impose no requirement that securities transactions be executed on the official stock exchange, these same Member States have active "off-the-floor" markets in listed securities; in at least three of the Nine, trading on these unofficial markets far surpasses trading on the national exchange floor itself, both in volume and importance [1]. Lastly, loosely organized, semi-active parallel securities markets exist not only in securities of local significance, but also in important foreign securities which, due to insufficient volume, for example, are not admitted to the official stock exchange. In addition to these centrifugal forces, when one considers that each Member State also has its own individual rules on admission, trading, control, etc. of securities, it becomes apparent just how powerful the forces of division are in the EEC.

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1.2. The forces of integration: contributing factors and efforts

Several factors, although not necessarily a counterbalance to the centrifugal forces present, nevertheless encourage integration of securities markets in the EEC.

1.2.1. The Eurobond market

The most important factor contributing to integration is the Eurobond market. Although it stretches all over the world, it can nonetheless be classified as a European securities market since its main centers are still located in Europe. The Eurobond market is so highly integrated that it is often described as a "supranational" market, lacking a seat or domicile and therefore any submarkets. In fact, the Eurobond market is closely interwoven with the domestic securities markets of the EEC members since the market is an alternative capital source where states, public agencies and institutions compete with international organizations and private enterprises for long-term funds. The success of the Eurobond market is due tó some extent to the fact that national authorities have exhausted their domestic capital markets so that these cannot offer any real competitive alternative to the Eurobond market. This is particularly true as regards the more important securities issuers whose issues can be placed on the Eurobond market with greater speed and efficiency than on national securities exchanges. Unfortunately, since only debt securities are issued on the Eurobond market, companies are compelled to raise equity capital on their own and other Member States' already over-subscribed domestic capital markets (table 1).

1.2.2. Links between the national securities markets

The fact that there are nine distinct national securities markets in the EEC, each regulating its own interests, does not mean that contacts do not exist between the stock exchanges. First, arbitrage has been linking securities transactions among the

Table 1
The new issue market in Eurobonds [2]

	1975	%	1976	%	1977	%	1978	%	1979	%
1. Governments and public institutions	3,031	46	4,857	40	5,658	39	5,060	44	3,836	31
2. International organizations	548	8	1,374	11	1,550	11	1,324	12	1,182	10
3. Private enterprises	3,009	46	6,037	49	7,432	50	5,077	44	7,215	59
Total	6,588		12,268		14,640		11,461		12,233	

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national markets for many years and as more and more securities are listed on more than one stock exchange, its importance will probably increase. Second, participation by large banking or brokerage firms in several stock exchanges serves to link "independent" markets. A good example on the national level is Germany, where the larger banks have direct access to each of the German stock exchanges; on the European level, a similar example is Luxembourg, where the majority of the members of the Luxembourg stock exchange are foreign-controlled banks.

This second integration factor — links between the national securities markets through broker participation — has been thwarted in its development on the European level because the Treaty of Rome principle of "freedom of establishment" is not yet considered applicable to securities brokers. Some securities traders have the legal status of "public officials" in their countries, and as individuals exercising state authority, the Treaty of Rome exempts them from the freedom of establishment rule (Art. 55 of the EEC Treaty).

1.2.3. Internal integration on the national exchanges

Integration of the different domestic markets has been much more successful on the national level. Three of the Member States (Denmark, Luxembourg and the Netherlands) have only one stock exchange, while the French stock exchange authorities do not permit multiple listings. The regulatory frameworks upon which the national markets are structured represent varying degrees of integration: the United Kingdom and Ireland merged their securities-brokers' associations, although they maintain distinct trading floors which are not linked except by arbitrage (telephone). Virtually identical regulations apply to each of their regional stock exchange floors [3]. A movement towards uniformity can also be perceived in the regulatory scheme of the German securities markets, where the eight state stock exchanges were created by federal law. Although these independent bodies were organized along state lines, each has adopted uniform stock exchange regulations. France is likewise traditionally inclined towards centralization, which has expressed itself in the fact that all stock exchanges are governed by the same decree. Italy has also followed the path of uniformity: in 1974 the Italian securities markets were reorganized so that regulations were made identical for each of the ten Italian stock exchanges. Finally, integration of the national markets is brought about in most of the Member States by the admission of the same securities to several of the domestic stock exchanges and by the participation of the same brokerage firms in several of these exchanges.

1.2.4. Supranational efforts towards integration: the OECD, the FIBV and the EEC

Attempts to better integrate the European securities markets have mainly consisted of legal or regulatory measures. Several international bodies and associations have drafted recommendations, resolutions and directives in order to encourage integration or "interpenetration" of the markets, *e.g.* the recommendations of the Organization for Economic Cooperation and Development (OECD) and those of

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the Fédération Internationale Des Bourses De Valeurs (FIBV) [4]. Both the OECD and the FIBV lack rule-making authority; their recommendations or resolutions are not legally binding upon their members, whether states or stock exchanges. On the other hand, the European Economic Community has adopted several measures in this field, some of which have a legally binding effect since Member States are obliged to implement internal legislation in conformity with EEC decisions.

(a) *The OECD.* The recommendations [5] of the OECD deal with the information to be disclosed upon the public issuance of securities. The first recommendation was published in 1974, and supplemented in 1976; this second recommendation contains very precise rules dealing with the content of issue prospectuses. The OECD recommendations do not expressly state that their purpose is to contribute to the integration of the securities markets. Instead, they state that their *raison d'être* is to contribute to the "progressive development of the financial markets, nationally as well as internationally" [6].

(b) *The FIBV.* The International Federation of Stock Exchanges (FIBV) [7] has dealt with the problem of the fragmentation and integration of the securities markets on several occasions. Obviously under the influence of the United States delegation to the FIBV, which was then struggling with its own National Market System, the Federation adopted a resolution in October 1975 recommending the concentration of all securities transactions on FIBV member stock exchanges. This recommendation was reissued in 1977. Furthermore, in both 1975 and 1977 the Federation adopted a proposal on multiple listing, referred to as "multinational listings" in the resolutions themselves. Minimum requirements for admission and disclosure were proposed in order to facilitate multiple listings. The 1977 Resolution used very broad language, stating that "it is in the interest of all people concerned to encourage the official listing of securities . . . An important step forward would be set by adopting uniform minimum admission conditions . . . ". Although the idea of market integration is wholly absent from the explicitly stated motives of these recommendations, they nonetheless encourage it.

(c) *The EEC.* The harmonization, liberalization and integration of the securities markets in the European Community were recognized as necessary by EEC authorities very early in the development of the Common Market. The Treaty of Rome seeks to abolish obstacles to the free flow of capital within the EEC. Three Directives, each based on Article 67 of the Treaty, have made important contributions towards this goal, but no significant progress has been made in abolishing the remaining restrictions since 1962 [8]. At present, the following summarizes the situation as far as stock exchange transactions are concerned: all dealings on the stock exchanges have been liberalized in general, but restrictions remain in force with respect to the issuance of foreign securities and the acquisition by residents of foreign securities denominated in their national currency. Off-the-floor markets have not yet been liberalized by the Community. Actual harmonization measures have been few, but the recent Admission of Securities to Official Stock Exchange Listing Directive [hereinafter Admission Directive] is of substantial importance [9].

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Another very important directive, the "Sixth Company Law" or "Stock Exchange Prospectus" Directive [hereinafter Prospectus Directive], is expected at any time [10]. Other proposed directives concern continuous (interim) financial disclosure by issuers of securities listed on the Member State stock exchanges [11] and investment funds [12]. In addition, certain company law directives, four [13] of which have been adopted by the European Community out of eight in preparation [14], have had beneficial, albeit indirect, impact on the integration of the market in company securities [15].

1.3. Integration factors in the harmonization directives

The relationship between these harmonization directives and the idea of integration of the securities markets needs further examination. Taken as a whole, the purpose of the harmonization directives is to implement a regulatory system in the Member States of the European Community which will provide equivalent safeguards to investors. These directives are based on Article 54(3)(g) of the Treaty of Rome, an article that is part of the Treaty's chapter on the freedom of establishment and services; they are not based on the articles dealing with the liberalization of capital flows. According to Article 54(3)(g), the Council of Ministers and the Commission of the European Communities shall take appropriate steps to coordinate "to the necessary extent the safeguards which, for the protection of the interests of members and others, are required by Member States of companies or firms ... with a view to making such safeguards equivalent throughout the Community".

The clearly delineated powers of the European authorities should be underscored. They do not permit the authorities to order the integration of the securities markets; rather, they allow them only to introduce equivalent safeguards for the protection of participants (shareholders) or third parties (creditors, bondholders, etc.) [16]. This limitation to matters dealing with the coordination of investor protection suggests that a certain minimum equivalent must be insured: Member States retain their freedom to impose additional safeguards or to impose additional nondiscriminatory provisions [17]. This is clearly evident in the adopted Admission Directive and the Prospectus Directive, neither of which goes beyond fixing minimum conditions or requirements.

Harmonization of admission conditions and disclosure requirements will facilitate the admission of securities to more than one stock exchange. However, listing on one Member State's stock market will not result in automatic admission to the other stock exchanges in the Community, since Member States are still permitted to impose "additional" or "more stringent" requirements upon securities issuers applying for admission to their stock exchanges. This will effectively restrict access even for securities which have already been listed on another EEC exchange. The Community method is therefore much more modest than the United States approach, which achieves much more thorough integration by making all securities listed on one stock exchange eligible for trading on all other stock exchanges or markets [18].

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Harmonization of admission requirements will therefore stimulate multiple listings. Today, most of the European stock exchanges (except those in Italy) [19], are eager to admit securities listed in other Member States and on several occasions issuers of securities have applied for admission to several European stock markets simultaneously. Community authorities officially encourage this development since it helps to further the Community's goal of integration.

As mentioned earlier, under the Admission Directive, national securities authorities retain decision-making power over the admission of a security [20] to their exchanges. However, the Directive does significantly curb any tendency to arbitrarily refuse admission to a security since Member States may only impose additional or more stringent requirements if these are first, explicit, and second, published before the application for admission is introduced. Moreover, according to Article 5 of the Directive, these requirements must exclude any discriminatory treatment. These rules with respect to additional admission conditions not only serve to effectively curtail the discretionary powers of the admission authorities, but they also grant the legal right to be admitted to issuers who comply with all admission conditions published by the Member State. Both points require some further elaboration [21].

Once the Member States implement the minimum admission requirements set forth in the Annexes to the Directives, they may impose additional conditions, "provided that these more stringent and additional conditions apply generally for all issuers or for individual classes of issuers and that they are published before application for admission of such securities is made" [22]. These two requirements tend both to insure that any national admission conditions enacted in addition to the Directive's uniform minimum conditions are objective, and to prevent any arbitrary refusal.

The requirement for objective admission conditions not only applies to traditional admission criteria (minimum capital, minimum number of securities in circulation, etc.), but also to policy requirements (monetary, foreign exchange) and to any other motives that have previously been invoked to deny admission to a security. This interpretation of the Directive is justifiable, even though it is directly opposed to the goals expressed in the Directive's preamble [23], for two reasons: first, a literal reading of the Directive supports this view, and second, an examination of the area in which the rule of Article 5 is inapplicable buttresses this interpretation of the Directive. According to Article 10 of the Admission Directive, the admission control authorities may depart from the objective additional conditions rule of Article 5 in the area of investor protection only. So-called "special conditions" – not "additional" as they are called in Article 5 – may be imposed only when they contribute to the protection of the investor.

In contrast to the provisions of Article 5, Article 10(*1*) does not require these "special" conditions "to be published before application for admission . . . is made" [24]. The national stock exchange authorities need only inform the applicant issuer that they are requiring these conditions. Since unique questions of investor protec-

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tion may arise during the control procedure, issues that could not possibly have been itemized in the standard "schedule for admission" of a particular Member State, Article 10 allows the relevant authorities to supplement their normal admission criteria with "special" conditions tailored to the particular individual case [25]. Since prospectus requirements fall into the category of investor protection, they could probably be treated as "special" conditions. In sum, discretionary admission powers have been removed from the rule-making authority of the Member States except in the area of investor protection. Any restrictions based on general political or monetary policies which the states desire to retain in their securities admission procedures will have to be explicitly stated in a published instrument so that issuer applicants will have notice of the additional conditions before demanding that their securities be listed on the specific stock exchange. Thus, for example, if the Belgian Minister of Finance wants to refuse to admit bonds issued by a Luxembourg financial holding company, on the grounds that the securities in question contain an inherent risk of tax fraud, he will only be able to prohibit the listing of the bonds on the Belgian Stock Exchange if, prior to the time the application for admission was filed by the Luxembourg firm, the Belgian Minister of Finance had explicitly stated that Belgium will not admit any securities to the Stock Exchange that are issued by, for example, enterprises incorporated in Member States lacking a withholding tax.

If a listing on the stock exchange may not be denied to an issuer who complies with the objective standards for admission, it is a logical, indeed inescapable, conclusion that these issuers have a right to be admitted. This right of admission is of central importance to the philosophy upon which the harmonization directives are predicated: giving the complying issuer a right to access considerably restricts the freedom of the national admission authorities to refuse admission. According to the preamble to the Admission Directive this individual right will "make for greater interpenetration of national securities markets", for as larger securities issuers broaden their search for available equity capital to other Member States, multiple listings will follow, and serve to bind the distinct national securities markets more closely to one another.

The Admissions Directive contains another feature which is likely to be a factor in encouraging the integration of the European securities markets. Although the Directive does not deal primarily with information disclosure, it does require issuers of stocks and bonds admitted to one of the European stock exchanges to publish, at minimum, information equivalent to the information disclosed on any other stock exchange to which the stocks and bonds in question have been admitted [26]. This equivalence rule applies in the case of securities "listed on stock exchanges situated or operating in one or more Member States and in one or more non-Member States", a reference not only to securities listed in the Community, but also to those listed on stock exchanges in Japan, Switzerland, and the United States. The Directive does, however, provide that in the latter case the information need only be published if it "may be of importance for the evaluation of the shares" [27].

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The effect of this equivalence principle on the integration of the European securities markets may prove to be even broader since several Member States still have disclosure procedures that differ greatly from internationally accepted standards. Thus, in those Member States whose securities laws have yet to require financial disclosure (*e.g.* Belgium, where "on-going" or continuous disclosure is still governed by generally applicable company law), the requirement will be introduced into the respective legal systems because the Directive requires issuers of securities with a multiple listing to publish equivalent information. Disclosure procedures in the Member States will therefore be forced to rise to the level of the disclosure policy of the most exacting Member State. Even in the absence of national disclosure rules, the Directive's equivalence rule will have to be implemented by the national authorities dealing with the listing or delisting of securities [28].

Whether individuals (*e.g.* investors) will, as a matter of right, be able to bring direct legal action to enforce this section of the disclosure policy depends on whether the European Court of Justice recognizes the direct applicability of the Directive not only to individual-state relationships, but also to disputes between individuals, *e.g.* investors and individual issuers [29]. The Admission Directive also contains other elements that will contribute to the integration of the European securities markets. A close reading of the Directive shows its rule-making philosophy to be based on a two-tiered policy that will probably guide all further harmonization measures in the area of securities regulation in the EEC: first, at the Community level a broad yet distinctive policy program is formulated centrally; second, implementation of the program is left to the Member States. Committees of National Experts under the guidance of the Commission produce a general plan for the harmonization of national regulations. The resulting council Directive is legally binding on the Member States. Yet the implementation of this centrally formulated program is left entirely to the national authorities: the result is agreed upon, but there is absolute freedom concerning the forms and methods chosen for implementation of the Directive.

A rather striking feature of the Directive is that both public regulatory bodies and private, corporative or self-regulatory organizations are put on the same footing as far as their acceptability as instruments for the implementation of the central policy is concerned. But from the perspective of the Community's legal order it is immaterial whether the obligations imposed by this, or any forthcoming, directive are implemented in Italy by legislative act, in France by changing a Decree, or in Great Britain by amending the Listing Agreement, which is no more than a private act. The EEC is not concerned with form or methods, but with results, so this mix of public and private authorities is acceptable, provided that the desired outcome is achieved. Similar reasoning can be seen in all other areas covered by the Admission Directive, with two exceptions: Article 15, which requires Member States to organize a review procedure of their own choice before the courts of general law, and Article 19 [30], which deals with matters of professional secrecy. State regulation seems inevitable in both of these situations [31].

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It is unclear whether the regulatory pattern described above will have to be followed in future harmonization efforts and whether it will necessarily result in integration of the markets [32]. However, it is apparent that the model of integration which would result from its adoption would be very different from the system which exists in the United States, where the central government agency, the Securities and Exchange Commission, has been directed by Congress to use its authority to establish a national market system in which all separate market centers will be required to participate. Europeans obviously do not desire this type of central control body, but even if they did, strong legal, especially constitutional, objections would be raised if a central control authority were granted such extensive power [33].

This preference for decentralized local or national control is reflected in several other European measures relating to securities. For example, even though the content of the rules under the Admission Directive is fixed at the Community level, it is the domestic authorities who supervise the actual application of the rules and also perform all control and surveillance activities relating to them. In a sense, the need for vigorous central policy-making is harmoniously joined with the need to respect the characteristics of each Member State's legal system. This is so because it is assumed that each is equally suitable to furthering the Community's goals. The European authorities will monitor the acts of the Member States to be certain that the Directive's guidelines are in fact implemented and respected: apart from the possibility of individuals asserting the direct effect of the Directives before domestic courts, it is the Community that bears full responsibility for ensuring that Member States implement Community obligations [34].

This last issue may present novel difficulties. In several Member States the implementation of the Community Directives will occur through a legislative process in which a statute will be changed. At least two Member States have a long-standing tradition of so-called "self-regulation" and "corporative regulation" [35]. Since the Admission Directive and future European Directives will not be concerned with implementing techniques, a problem may emerge: purely private rules will indeed implement the binding Directive provisions satisfactorily, but since these acts do not, legally speaking, constitute state action, it is questionable whether individuals will have a private right of action against private bodies that do not respect Community norms in the area of securities regulation. Recognition of horizontal direct effect with regard to Directives would resolve the problem favorably even from the viewpoint of those defending self-regulation [36].

2. From harmonization to integration

Efforts to harmonize the European securities markets are necessary and useful in that they lay the foundation for future integration. However, these current efforts, though encouraging integration, will never bring it about. European investors may indeed enjoy, if not identical then at least "equivalent", safeguards with

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respect to securities admitted to stock exchanges within the Common Market. Additionally, the flow of capital will be freer and foreign stock exchange markets will likewise be more accessible. But all this falls short of integration. It would in fact be possible for the European market structure to remain divided into nine distinct submarkets, each having its own traditions, regulations, etc. and yet for these same markets to be freely accessible and also compatible with one another. Links between these submarkets would be limited to arbitrage for securities with a multiple listing.

The disadvantages of permitting the Community's securities markets to stop at this degree of harmonization are clear. First, investors will fail to derive any benefit from multiple listing, since arbitrage experts alone will reap the advantages of the continuing price differences. Second, regardless of where the order is executed, the investor will not receive the best terms to be had, nor will it be possible to execute an order for a particular security on the market with the best terms since stock exchange rules may require that orders be executed on the national stock exchange. Third, the combination of these two factors will have the effect of undermining investor confidence. Fourth, a large pool of long-term capital, so necessary if governments and enterprises are to satisfy their financial needs, will not be created because new securities issues will not automatically penetrate all the national securities markets; only so many as the issuer decides merits the effort of applying for a listing. Finally, the same administrative and procedural barriers on the national stock exchanges, which have hurt the securities exchanges in their competition with the Eurobond market, will continue to make the stock markets less attractive to investors.

Real integration of the securities markets in Europe cannot be achieved without interaction between all demand and all supply. Geographic price differences for a given security will then no longer exist. This integration of EC securities markets could be achieved if a three-pronged approach were followed: first, present efforts at harmonization were continued; second, measures for market and issuer related disclosure were adopted; and third, a communication network were constructed so as to insure better market transparency.

Beyond harmonization and liberalization, integration could best be promoted by connecting the different national submarkets with a telecommunications network. Such a system would enable market participants in Europe to receive information about the prices paid for securities, as well as the terms or conditions asked or offered for them ("quotes"). It would further enable intermediaries in the securities markets to execute orders directly with all other stock markets. A detailed outline for such an Integrated European Securities Market is set out below [37].

3. Towards an Integrated European Securities Market

The idea of an Integrated European Securities Market, which could effectively compete not only with the U.S. securities market but also – and perhaps more im-

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portant – with the Eurobond market, has become increasingly attractive in the last several years. Pleas for the construction of a Euro-Exchange have come from within the various Member States [38]; high-ranking stock exchange officials have likewise expressed interest; the Commission of the European Communities has endorsed the idea [39]; and one Dutch author has gone so far as to present a fully developed scheme for a European securities market [40]. The elaborate scheme for an Integrated European Securities Market which follows is an attempt to further stimulate the current thinking and reflections on the subject [41]. This proposal for an Integrated European Securities Market does not purport to deal with all the issues, nor does it take into account the sequence of decisions that would have to be followed in organizing the new system.

A brief examination of some essential policy questions is necessary before the proposed scheme can be fully understood. First, an integrated market is one in which *all* buy orders for a security (wherever they originate) interact with *all* sell orders for that same security. Theoretically, these competing forces result in a market equilibrium, at which point the order is executed at the "best price". Practically speaking, efficient interplay of market forces results only from general order interaction. This interaction can be achieved only through the use of telecommunication equipment and techniques which facilitate the transmission of information and orders between all markets and between all participants in those markets. These telecommunication techniques are different from automated execution systems because in the former the final decision to execute a transaction always remains with the market participant placing the order in the system. Second, organization of an integrated market does not necessitate departure from present stock exchange rules that require all orders for listed securities to be executed on national stock exchanges; nor does it necessitate a change in rules that restrict security transactions to "official securities traders", whether brokers or dealers. The current surveillance system can also remain unchanged provided that it affords sufficient safeguards to participants in the integrated market. Third, it must be emphasized from the outset that the organization of an integrated securities market is a gradual process. Indeed, the move from the present fragmented market system to a unified market must be a slow, step-by-step occurrence so that the healthy market equilibrium currently in existence will not be unduly disturbed.

3.1. The securities

Only the most important and most active securities presently listed on the national stock exchanges would be eligible for participation in the Integrated European Market System. This might mean that only securities with a multiple listing would be admitted to the System, or at minimum, that no securities would be granted entry to the System unless they had been previously admitted to one of the national stock exchanges. This transfer of a security from its national stock exchange to the Integrated European Market System would occur automatically

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and would be governed by objective criteria such as the number of securities issued, minimum capital, trading activity on the national exchanges, etc. The national authorities charged with admitting securities to the stock exchange would continue to be competent authorities with respect to the primary admission of securities to the exchange. They would also continue to administer any applicable rules relating to disclosure or dealing with business ethics and behavior [42].

Organization of the Integrated European Market System would not inevitably result in the abandonment of the present policy of multiple security listings. Computer technology is sufficiently advanced to permit the exclusion of any transactions in securities that have not been officially admitted to the Stock Exchange in the Member State from where the order originates. All orders for these securities would have to be executed by a securities trader in another Member State where the issues were listed. This practice is identical to the present system except that in the Integrated System order transmission would be greatly facilitated. Thus, for example, in Italy, where very few foreign securities are presently listed, and provided that Italian residents would not be prohibited from acquiring such securities abroad, an Italian bank or broker would be able to purchase all Systems securities by transmitting his order to a London broker or to a Luxembourg bank, even if these securities were not admitted to the Italian stock exchanges.

It may actually be advantageous for Member State to retain the present multiple-listing policy since it enables them to control their own admission policies more easily. However, as admission conditions and prospectus requirements gradually become more and more harmonized, the usefulness of maintaining a nationally distinct admission policy will become less apparent. For issuers, this progressive harmonization will undoubtedly make multiple listing less burdensome and undercut existing objections to multiple listings.

3.2. The telecommunications system

Integration of nine national securities markets into a single unified market can be achieved only by connecting these different national markets with a sophisticated telecommunications network. Such a network (which would utilize already existing telephone lines) would transmit information processed by one or more computers located in one or more Member States. Terminals in the form of CRT (cathode ray tube) screens would permit on-line access to the Integrated Trading System.

The question of the language to be utilized in the telecommunication system is not a particularly important problem, but it would need to be decided whether harmonization could best be accomplished by adopting a specific language or whether some type of "translating" computer could be used. A second related technical problem is whether a single computer would be used, or whether – and what is probably preferable – different national computers would be used. This system of interconnected computers raises the possibility of nonparticipation of some Mem-

ber States in the Integrated Market, or perhaps participation in one direction only, *i.e.* permitting the System to be used in domestic securities trading, but forbidding residents from using the System to purchase foreign securities.

What information would be transmitted through the System telecommunication network? At a minimum, the System could function as a sophisticated multilateral "arbitrage system". Instead of the current frustrating arbitrage system, in which the participating brokers must telephone several correspondents before an order can be placed, the new communication system would work like a private telex system and allow market participants to transmit their orders more efficiently. This minimum approach is unsatisfactory, however, because it does not provide market traders with the vital information necessary for the giving of arbitrage orders. The deficiency could be corrected in two stages: first, on-line access to sales price information on member stock exchanges could be provided, and second, information as to "bid" and "ask" prices ("quotes") on these same markets could be given.

Every European stock exchange has had a transaction reporting system from the beginning: they are called the daily stock list, the "cote officielle" or the "prijscourant". Generally, these price lists contain daily summaries of prices reached on the stock exchanges, but they are available only after the closing of the trading day and deal with prices reached on the particular exchange only, to the exclusion of transactions that occurred on other stock exchanges. Some Member States have more technologically advanced reporting systems that furnish information concerning completed exchange transactions and, in at least one case, even synthesize information obtained from several participating exchanges.

A computerized transaction reporting system can best be compared to one of these "daily stock lists" but with the important distinction that the information would be available on a real-time basis, and would therefore permit not only brokers but also investors to intervene in the market – in the process of price formation – for example, by placing additional orders or instructing their brokers to do so. This electronic newspaper would also combine price information from all the European stock exchanges. The introduction of such a communication system would not result in any harmful side effects. Present trading patterns and habits on the stock exchange floors would not be disturbed too greatly. Brokers would only have to alter their trading patterns to the extent of having to use special "slips" when executing orders, and then having to turn in these "slips" to a central repository which would read, analyze and process them electronically.

Information collected on each of the national stock exchanges would be made available to all stock exchanges, brokers and investors willing to pay the service charges. Several techniques could be used to redistribute this information: last sale information could be retrieved by all subscribing parties by having all prices at which the last sale(s) has been executed displayed on their CRT terminals; another method would allow display screens simultaneously to show last sale reports that relate to each of the national exchanges, thereby permitting arbitrage to flatten out any price differences. Finally, trading activity could be followed by a sequential

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projection of all sale reports in all or a selected list of securities. Arbitrage would become more transparent, more accessible, and therefore much easier, since all market participants would be simultaneously informed, on a real-time basis, of all market movement on each of the national exchanges. This would enhance integration of the securities markets since price differences which would keep the national markets distinct would be unable to survive the pressure of this form of arbitrage.

In addition to this arbitrage-oriented transaction reporting system it would prove highly useful to install a second communication line through which brokers, and possibly other market participants, would be able to direct buy or sell orders from their own market or office to any other European stock exchange. Essentially, this would only entail improvement of present communication techniques, since telephone calls and telex messages through the official telex system would simply be replaced by a more streamlined, uniform, and exclusive telecommunication system. This order transmission system would enable brokers or dealers having access to one of the national stock exchanges to direct orders to their colleagues on other stock markets. The orders would then be executed in the normal way, *i.e.* with the intervention of a local broker. Orders could be transmitted from the floor of one exchange to the floor of another exchange, or from the offices of the order-directing brokers to the receiving exchange floor. It would be up to each of the participants to choose his correspondents on the other stock exchanges, a practice that would coincide with present methods of trading. Order execution would require, in accordance with national regulations, the intervention of a broker who would execute the order on the stock exchange according to existing practices on his exchange. Thus, for example, the receiving broker would bring the order to the floor and if it could not be executed at once he would treat it according to prevailing rules with regard to unexecuted limit orders. Unexecuted market orders would be reported back or might instead lapse automatically after a very short waiting period. When rules relating to stock exchange trading become more fully harmonized, a final step would be to enable order execution to occur without the intervention of a broker on the receiving stock exchange [43].

Attention should also be focused on the so-called parallel markets in which listed securities are occasionally traded at more favorable prices than on the stock exchange itself. The best approach is probably not to compel the Member States to enact legislation requiring all transactions in listed securities to be executed on the stock exchange because it would be difficult to monitor implementation of such a restrictive requirement. In addition, it may be a mistake to prohibit market-making activity outside the stock exchanges: so long as the transparency of the market is not threatened it may be unwise to force all trading in securities into the single confining "mold" of commission brokerage.

The existence of competing alternative forms of dealing may greatly benefit market health. Parallel market-making activity could be permitted, provided that all transactions occurring in these off-the-floor markets were reported to the Integrated European Market System and dealers were also required to transmit bid and

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ask prices to a central quotation system (discussed *infra*). Similarly, other differences in the methods and techniques of stock exchange trading in the Member States could be reconciled by requiring all trading, regardless of form, to be reported in this same transactions reporting system [44].

Informing market participants of prices realized on a national stock exchange, although relevant to any decision whether to place an order for a security in the future, will only partly achieve the goal of market transparency because reported transaction prices relate only to historical information. Indeed, complete interaction between the national securities markets will only occur when all market participants have ready access to information dealing with the offer of and demand for securities. It will always be somewhat of a gamble to transmit an arbitrage order unless one knows not only what the most recent transaction prices are, but also what the present state of demand and supply is for the security or securities in question. Price differences between national markets will never be eliminated until market participants know the terms and conditions offered on all markets. Therefore, a third communication system would have to be created, in which the "bid" and "ask" prices on each of the national stock exchanges would be collected, transmitted, processed, classified, and rebroadcast to all market participants. In possession of information from this central quotation system, participants could continuously determine what price differences (if any) for a given security existed between the national markets and, all other factors being equal, this knowledge would enable these same differences to be erased. The result would be the effective integration of the markets, since all prices on the European stock exchanges would be largely identical.

The organization of an integrated quotation network would not, from a technical point of view, pose insurmountable problems. At present, there are two trading techniques for securities on stock exchanges in the Member States. First, some stock exchanges require all transactions to be executed through a "market-maker", *e.g.* a jobber on the London Stock Exchange. This means that no bid or ask orders are recorded as such, but that the status of the market is reflected solely by the jobber's quotes. A second, and different technique of securities trading is followed by the majority of Member States: buy and sell orders are collected by the stock exchange authorities who then use this information to set an equilibrium price, *i.e.* the price at which the largest amount of orders for a given securitiy can be filled. In several Member States no price equilibrium can be set unless all brokers have been allowed to intervene in the price-fixing procedure, for example by subsequently offering securities at a more favorable price. After the price is initially set, brokers then trade in securities by matching their orders with those limit orders displayed after the price equilibrium procedure has been followed.

These two types of securities trading will have to be harmonized. First, the jobbing system will need to be included in the auction trading system currently followed by the majority of the Member States. The best approach would be to consider the London jobber's quote as simply the position of one of the participating

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stock exchanges. London jobbers would then be required to introduce the quote(s) they are currently displaying on the trading floor on London into their system terminals [45]. With respect to the auction procedure that is followed in most other stock exchanges, the "current quotation" in the integrated quotation system would consist of the aggregation of all bid and ask orders communicated on the floor of each of the exchanges. Thus, for example, if there was an aggregate demand for 1,500 shares XYZ at a price of 15 each on the Paris Bourse, and an aggregate offer of 700 of the same shares at the price of 16, the current quotation would be transmitted as follows:

	quantity	B	A	quantity
Paris	1,500	15	16	700

This 15/16 quote would be comparable to the quote coming from the London jobbers:

London	500	$15\frac{1}{4}$	$15\frac{3}{4}$	200

Similarly, all other stock exchanges would collect comparable aggregate data and transfer them into the electronic systems. The most favorable current bid or ask offer would be classified first. Furthermore, all participants would be informed simultaneously as to the price differences among each of the national stock exchanges. Since arbitrage would be made much easier by the above-mentioned order transmission system, price differences between the Member States would disappear almost instantaneously. If a London jobber were to offer a bid price higher than the price prevailing on another market, he would attract a large number of orders. If he considered the number to be excessive and therefore undesirable, he would lower his bid to the level comparable to the current bids prevailing on the other stock exchanges. Arbitrage would be multilateral: price differences between Paris and London would be bridged by orders coming not only from Paris, but from Amsterdam, Brussels and Frankfurt as well. A further advantage of the proposed integrated quotation system is that commission orders would be matched against commission orders as well as against market-maker quotations. Trading on the market would no longer be limited to just commission business or just market-making activity. Rather, market health would be enhanced since both forms of dealing, in competition with each other, would constitute market trading.

Orders at the market may require separate treatment. On most of the European stock exchanges these orders are executed during the first hour of trading on the exchange; it is this activity which in fact gives rise to the "opening price". This present technique is not incompatible with the new trading procedures proposed. At the opening of each market day all orders placed on each of the national exchanges would be transmitted to the integrated quotation system and electronically processed; the proposed equilibrium price would be communicated to all stock exchanges. Brokers and jobbers would then be able to offer more securities or to place new purchase orders, both of which would influence the opening price. After

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this early morning "auction" had occurred, the daily opening price would be fixed. All future trading would occur against the unexecuted limit orders. New orders could always be added and all would contribute to the establishment of that exchange's current quotation. All market participants could at any given moment request the CRT display of the composite quotation for a given security and then use this information to choose the most favorable market for the execution of their orders.

The proposed telecommunication system attempts to preserve the present patterns of securities trading in the Member States as much as possible. When these can be made compatible – and they can – there is no reason why any of the European states involved should abandon their systems. Furthermore, integration of different patterns of securities trading offers a wider range of possibilities within the system itself. Retaining present rules and structures would not necessarily sacrifice the transparency, fairness, liquidity or depth of the securities market.

Automatic order execution, in which a transaction is entered into as soon as a response to a displayed limit order is put into the system, should be dealt with briefly at this point. If necessary, some type of automatic execution facility could be added to the proposed telecommunications system. Such a facility, which might be especially useful for smaller orders, could be connected to the overall system. It would constitute merely one of the methods for executing an order for a security and would result in nothing more than an additional quotation on the CRT screens.

A final remark should be made about the clearing and settlement of executed transactions. Obviously, once the first step towards integration will have been taken, and all transactions will have been reported in an electronic system, then clearing and settlement of the transactions will have to be dealt with electronically as well. Here again it might be preferable to connect the present national clearing systems with each other rather than to construct one mammoth clearing system. So long as the national clearing systems acted in concert, this approach would be successful.

3.3. An appropriate regulation for transactions in the Integrated European Market System

Certain aspects of securities trading within the Integrated European Market System would have to be commonly regulated, or at least a thorough policy of harmonization pursued. Otherwise the danger is that the complexity of these new trading techniques would frighten their intended users who have a traditional dislike for electronic systems. The set of rules which follows could be enacted in each Member State according to national rule-making procedures, provided that its contents, if not identical, are at least highly comparable.

First, the regulation would describe the conditions under which the integrated market would function. Procedures of order transmission and execution would receive special attention, since the reliability of the system is in issue. Certain ques-

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tions would have to be dealt with. Under what conditions would the refusal of an order, transmitted in response to a quotation communicated by one exchange to another exchange, be permitted? [46] How would order precedence be determined in the situation where several orders are simultaneously transmitted in response to the same quotation? These and other technical questions would have to be resolved after study. Another, and more general issue which would have to be resolved before an integrated quotation system could be organized relates to the question of whether the offers contained in the quotations are legally binding, or instead, whether they are mere invitations to make an offer. Since it is essential that offers in the system be reliable, the correct solution of this problem is extremely important: it will determine whether the entire system is functioning correctly or not. In the United States – contrary to the approach followed by Eurex – the offer has been declared binding by government regulations. In Europe, quotations furnished by the stock exchanges and by London jobbers are firm. Additional rules will need to be made concerning the number of securities which may be offered in these quotations. As far as the stock exchanges are concerned, this is merely the aggregate of the quantities for which limit orders were transmitted to the stock exchange. An appropriate rule to deal with traders such as the London jobber or other market-makers will have to be made as well.

It would be preferable to limit System trading to cash transactions. If some Member States felt it desirable to add some form of leverage, this could be organized at the broker–investor stage of securities trading, so that it would not affect the market itself. Furthermore, at least one Member State is presently considering the possibility of closing down its forward market (marché à terme). Whether other forms of negotiation (*e.g.* options) should be included in the Integrated Market will be deferred for later analysis. Limit orders, however, would fit into the proposed system very well, while orders at the market could easily be integrated into the overall trading system.

It would not be necessary to denominate the entire securities market in a single currency under the regulation, although this would be possible and has been proposed as a way in which to support the European Monetary System. At least in the beginning, all transactions, quotations, etc. would have to be expressed in the national currency in which the security itself is denominated. Thus, transactions would be in the currency of one of the Member States, usually the currency of that Member State where the principal office of the issuer is located. Securities which could not comply with this rule would be traded in an agreed upon EEC currency, or even in their own national currency. It would be up to the Member States and their respective stock exchange authorities to decide whether they prefer to receive data flows expressed in the original transactions currencies, or in their own national currency. If necessary, a "translation" computer could be utilized to convert the various currencies present in the central data flow into a given national currency, as communicated by the foreign exchange authorities or by the foreign exchange markets.

The fundamental requirement that securities be traded under more or less comparable conditions in each of the Member States demands that identical, or at least largely harmonized, rules govern the conduct of investors acting as principals for stock exchange orders. Specifically, rules dealing with abusive practices such as price manipulation or insider trading will have to be introduced. An integration proposal ought not to fail to deal with these issues since otherwise some national securities markets would be protected by rules against insider trading while other, equally accessible markets would not, and therefore would be open to possible abuse. Safeguards in this area should be agreed upon centrally, but implementation and enforcement should be entrusted, as always, to the national authorities. The investigation of alleged violations within the system should likewise be initiated by a central surveillance authority, but further legal action, such as prosecution, should be left to the appropriate national corporative or judicial bodies.

3.4. Access to the Integrated European Market System

Formulation of totally new rules to govern access to the Integrated European Market System might disrupt integration of the securities markets. Therefore, the discussion which follows starts with the assumption that, insofar as access to the stock markets is concerned, as little as possible of the *status quo* should be changed. Thus, access to the Integrated Market System would be governed by national laws and regulations: only those firms or enterprises with access to their own national stock exchanges would be connected to the System's telecommunications network. Under this rule, for example, no banks would be granted access in Belgium, Denmark, France, Italy or the United Kingdom. In these countries the banks would have to transmit their securities orders through a stock exchange broker who would execute the transaction for them in the System.

Allowing access to be governed according to this scheme may give rise to some objections. In at least three of the Member States (Luxembourg, The Netherlands and the German Federal Republic) banks have direct access to the stock exchange. They would likewise be permitted to participate directly in the Integrated Market. Since some of these banks, especially those established in Luxembourg, are affiliated with banks established in Member States which deny banks direct access to the stock exchanges (e.g. a French bank with its Luxembourg 100% affiliate), this might seriously jeopardize present rules requiring all transactions in listed securities to pass through the hands of a stock exchange broker [47]. This concern, that transactions in securities would be diverted from one national market to another, would not affect the proper functioning of the Integrated Market System provided that all orders finally were executed in the System. But if Member States felt compelled to protect their own intermediaries, they could enact rules requiring their national financial institutions to direct stock exchange orders to national securities brokers only. It should be mentioned that the problem of transaction diversion already exists today and legislators have not felt it necessary to limit order trans-

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mission to the main market for the security involved, even if the security is listed locally. Cost considerations and communication difficulties have kept most orders, even for foreign securities, on the national markets. On the contrary, since it might hamper the integration of the securities markets to allow each Member State to protect its national market in this decisive manner, it might be preferable to forbid any rules which require banks to direct stock exchange orders through national brokers only.

The rule requiring all securities transactions to be channelled through a securities broker or bank should be distinguished from the rule that requires all orders for listed securities to be brought to the exchange markets. National regulatory systems present various possibilities. In some Member States off-board markets, essentially among banks, compete directly with the stock exchanges. It is accepted that this state of affairs, in which the banks avoid the use of a broker (who would be necessary if the trading were on the stock exchange floor itself), undermines the representativeness of price formation on the market. In at least two of the Member States [48] three-fourths to four-fifths of all trading in listed securities occurs off the exchange floor. In the United Kingdom and Ireland a somewhat comparable situation exists, essentially with respect to Eurobonds. Merchant bankers and comparable exempted dealers bypass the stock exchange and trade listed securities between themselves. Whether it would be necessary to adopt a rule at the European level requiring all transactions to be executed on the stock exchanges, and thus in the Integrated Market System, would depend largely on the success of the integrated market itself. If a considerable amount of activity in System securities were to develop outside the System, then one of the following could be done: either all transactions in securities could be required to occur within the System or, and what is probably the preferable approach, the reporting of all trading in System securities to the transaction reporting system could be required, along with a prohibition against any trading outside the System at more favorable prices than those within the System itself, unless all less favorable orders were first cleared.

A further development would be to extend access to the Integrated Market System to all intermediaries who, under their national systems, were allowed to engage in securities trading. This access would be permitted even if these intermediaries were bound under present national laws to transmit their orders to stock exchange brokers. Direct competition between brokers, banks, and possibly "courtiers" and "remisiers" would ensue; however, increased transparency combined with the competition of agency orders and market-making activity would sufficiently protect brokers who would find themselves in a relatively weaker position. In this case, all security intermediaries would be subject to a comparable set of rules governing their financial reliability. A surveillance mechanism to oversee their activities would be introduced as well [49].

In several Member States restrictions are imposed on brokerage firms in order to ensure their independence from outside influences that might exert undue pressure on their activities as brokers and investment advisers to their clients. Guaranteeing

the independence of the brokerage firms in question is achieved in the Member States in different ways: some restrict shareholdings in brokerage firms, especially by issuers; others limit their underwriting activities; still other Member States limit brokerage activity to single trader firms or to partnerships of securities dealers: Incorporated limited liability companies are forbidden. The participation of institutional investors as such is not expressly forbidden in any of the Member States. The inherent conflict of interest underlying the issue of participation of institutional investors in the securities markets has never been effectively solved in any national system. Only Germany has a Code of Conduct which imposes upon the banks involved a duty not to act against their clients. There have been no reported cases of a bank being punished by the light sanctions provided for infringement of this Code. Given the present stage of national rule-making, it is better not to deal with this issue on the European level, at least not where regulations governing the integrated market are concerned.

A more important question concerns the participation of nonresident brokers or stock exchanges. As long as the Integrated Market System functioned only as a linkage between stock exchanges, there would really be no problem. Japanese, Swiss and United States banks or brokerage houses could gain admission by becoming members of the Amsterdam or Luxembourg stock exchanges. Whether brokerage firms would be allowed to participate without membership on any exchange would depend largely on the financial guarantees offered by these firms. If identical or similar guarantees were offered, and if these brokerage houses were willing to observe Codes of Conduct or other ethical tenets, as declared applicable to the integrated securities market, then there would be no reasons not to admit them. Adequate surveillance would have to be organized, *e.g.* by the control authorities of the Member States where the offices of these firms are located.

3.5. Surveillance of market participants

The surveillance of market participants has a double function. On the one hand it must ensure that any broker trading in the market is sufficiently solvent at all times to meet all liabilities arising out of his market activity. Conversely, all market participants need to adhere to a common Code of Conduct: surveillance to ensure compliance with the Code will then be organized to guarantee honesty and equal treatment of all participants.

Elaborate requirements as to broker solvency already exist in most Member States. In some, brokers are bound to capital or to minimum assets requirements; in other Member States, bank guarantees or insurance coverage must be secured; while in still one other Member State (*i.e.* France), all brokers are jointly liable for all liabilities arising out of business dealings on the national stock exchange. It is in the interests of the European Economic Community that these safeguards be harmonized; but national legislation could determine how these protective measures would be implemented pursuant to a European-level policy decision.

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Since implementation of such safeguards may be very difficult, it would be best if a special additional guarantee system were developed. This system would cover all transactions executed in the Integrated Market System. Any safeguards decided upon would be programmed into the Integrated Market computer system so that, for example, any transactions exceeding set limits would be rejected, thereby automatically limiting the risks taken by participants in the market. Legally, these restrictions would take the form of guarantees by banks and insurance companies, and would be stipulated on behalf of any other market participant. Payment or execution on first demand would be provided for. The advantage of this simple formula is that it would avoid the technically difficult question of solvency rules imposed by national securities control authorities. These national rules would remain applicable and of interest to the banks or insurance companies guaranteeing the brokers' liability, but they would not have a direct influence on the functioning of the integrated market. It would be possible to use this approach as a complement to harmonizing the present national systems ensuring broker solvency. Implementation, surveillance, and any sanctions provided for in the system would be entrusted to the national control bodies. This approach to ensuring solvency would have the advantage of extending the protection to which public investors are entitled to cover all securities transactions, not just those which occurred in the integrated market.

This same division of powers between the European and national authorities would be advisable with respect to codes or rules of conduct for securities traders. The European Code of Conduct relating to securities transactions, recommended in 1977 by the European Commission, would be a model for a Code to govern the conduct of participants in the Integrated European Market System. In order for the integrated market to function correctly and equal treatment for market participants to be guaranteed, it would be essential that this or some other generally acceptable set of rules be declared applicable so that securities traders could be confident that their colleagues were complying with the same standards. In any case, the integration of the trading market itself would be greatly disturbed if the rules were not declared generally applicable and instead adopted by only some Member States.

Rules of Conduct, whether addressed to dealers in securities, company directors or investors in general, would be made applicable in each Member State by their appropriate authorities and in that form deemed most acceptable. The national control authorities would also be charged with surveillance and with enforcement of these rules; the European authorities would not intervene as such in either aspect of control.

3.6. Is control necessary on the European level?

From the previous discussion it should be apparent that it is neither inherently necessary nor desirable to organize a supranational, federal control body comparable to the U.S. Securities and Exchange Commission. First, several Member States

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have repeatedly refused to consider the creation of such a control authority and, second, it is doubtful whether the European Community authorities have any powers under present Rome Treaty provisions to establish new organizations entrusted with rule or policy-making powers or even with any competence exceeding administrative execution of their statutory mission. Third, the creation of a top-heavy and bureaucratic control body is not necessarily the only approach: it is possible to develop an alternative pattern of common rule-making that will provide for a sufficient degree of parallelism and equality of substantive regulation in each Member State and yet will not change the basic characteristics of present regulatory frameworks too much. Thus, different types of regulation which exist in the Community – public or governmental regulation, private or corporate regulation, and all other intermediate forms – would be put on the same footing.

The organizational framework adopted for integrating the European securities markets would be based on a division of powers: general policy-making would be formulated on the European level by the Member States acting in common, while implementation and surveillance of the schemes would be entrusted to national control authorities. On the Community level, a permanent organization would have to be created, composed of the Commission and representatives from each Member State. This organization would be charged with the creation of the Integrated Securities Market, its permanent role being the formulation of a common European policy on all matters relating to securities. In some ways, this proposed organization is comparable to the Contact Committees recently created pursuant to EC Directives.

The execution or implementation of this centrally formulated policy would be entrusted to national authorities. Each Member State would have to decide how it would translate the common policy into its own domestic regulatory system. Day-to-day administration and surveillance would be delegated to the appropriate domestic authorities, public or corporative (private). Implementation of the common central policy would be accomplished according to each Member State's respective legal system or traditions, whether by government law-making or by corporative self-regulatory rules or by other means, *e.g.* private contract forms. Just as is presently the case with EC Directives, compliance with this common central policy would need to be ensured. The European Community, acting through the Commission [50], or preferably through the proposed European-level policy-making body, would have to ensure that the rules are observed, and that implementation would result in equivalent conditions in each Member State.

This integration and rule-making scheme would not differ fundamentally from the approach presently followed by the Community in harmonizing national regulation through the use of Community Directives. However, the technique used to transmit the common central policy to the national authorities entrusted with its implementation must be made more effective and more flexible than is presently the case with Directives: market integration will never be achieved if the present five to eight year "gestation" period for Community Directives is not shortened.

The proposed rule-making framework would function best if it emerged as a

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procedure similar to the 1978 procedure worked out in the United Kingdom. In that country, the Council for the Securities Industry (CSI) acts essentially as a "policy-making body" for matters in which the entire City is involved [51]. Just as has been proposed for the EC organization, the CSI is never directly concerned with questions of control or surveillance: these remain in the hands of the corporate or professional organizations which support the CSI's activity.

Day-to-day functioning and surveillance of the Integrated System's telecommunications network would need to be monitored by a Central Market Management Committee (CMMC). It would be entrusted with all authority necessary to implement the common instructions dealing with the telecommunications system itself. The CMMC would be a technical, executive body that would ensure the smooth and correct operation of the System's electronic and telecommunications infrastructure. It would also be given certain surveillance powers with respect to transactions executed in the integrated network: insider trading or other forms of market manipulation would be a primary spotting task of the CMMC. If illegal conduct were suspected, further investigation would be handled by the national control bodies supervising the brokers during the particular surveillance period. These same authorities would also impose sanctions on these brokers. As all Member States and all participants in the markets would have a common interest in seeing that the market is free of illegal conduct, it might prove useful to go a step further and associate a representative of CMMC with the investigative and procedural activities undertaken by the national control bodies. This representative could act as a liaison between the different national control bodies involved. Article 89 of the Treaty of Rome contains a comparable division of duties in the area of investigations of violations of the Treaty's antitrust provisions [52].

3.7. The role of the national control bodies and the national stock exchanges

The formation of an integrated securities market is of direct relevance only to a limited number of securities. Stock exchanges would remain important for all other securities not touched by the Integrated System. It would be necessary in this regard to exclude local trading in System securities: otherwise, price differences incompatible with the concept of an integrated market would reappear.

The various existing stock exchanges and control bodies would retain their present powers and competencies in securities matters, but as far as the Integrated Market is concerned they would not be allowed to exercise these powers except in accordance with the centrally formulated securities policy. Whether a similar approach should be followed with regard to securities other than those admitted to the Integrated Market would depend on the choice made by the European authorities in accordance with their present harmonization efforts in the area.

The competence of the national control authorities in the field of securities regulation would include the admission of securities to the stock exchanges and all related issues, such as disclosure policies and rules of conduct for companies with

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securities listed on exchanges (*e.g.* takeovers, ethical rules for company directors, etc.). The admission of persons to the securities trading profession would likewise belong to national control organizations. So long as they participated in the Integrated System, however, all powers exercised by these control authorities would have to be in accordance with the common central policy formulated on the Community level. Thus, action on matters concerning minimum capital, guarantee rules, or surveillance systems to monitor brokers' activities would have to comply with the central policy. However, actual implementation of these rules would be left entirely to the national bodies: surveillance, investigation, and the imposition of disciplinary sanctions would be left to them. Admission of securities brokers to the Integrated Market would be automatic for all those who met the pre-fixed admission requirements (*e.g.* minimum guarantee, connection with all Integrated Market System facilities, etc.).

Rules governing the negotiation of securities within the System should be centrally fixed as well: otherwise, distortions in price formation would appear, caused by differences in the applicable rules. Matters concerning the legal definition of orders acceptable in the Integrated Market, the currencies to be used in price and quotation announcements, the status of limit orders, the revocability of orders, and so on, should be agreed upon centrally. Whether this same common rule-making policy would also extend beyond trading rules to cover questions such as the necessity of broker intervention in securities transactions, or the obligation of market participants to bring all orders to the stock exchange floor, or further, to techniques for executing orders (*e.g.* the prohibition of transactions by principals when orders are executed by agents, or the *Selbsteintritt* in Germany [53], leverage techniques, margin requirements, etc.), or for settling executed transactions, are matters to be discussed separately. But probably, several of the subjects could be left to the Member States' free decision [54]. Similarly, commission rates should be decided upon by the individual States: this would ensure competition among brokers within the Integrated Market System.

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Notes

[1] Denmark, Italy and, with respect to Eurobonds, Luxembourg as well.

[2] Source: Kredietbank-Belgium, Bulletin No. 44 (1979).

[3] In the Netherlands the three securities brokers associations were merged into one, called "Vereniging voor de effectenhandel". The local markets in The Hague and in Rotterdam were closed down in 1972.

[4] Founded in 1961, the FIBV is a consultative association whose members include the stock exchanges of fourteen different countries.

[5] Organisation de coopération et de développement économiques – Comité des marches financiers, Normes minimales de divulgation de l'OCDE, applicables à toute offre publique de titres (Paris, 1976). The efficient functioning of the secondary securities markets is expressly mentioned in the preamble to this recommendation.

[6] *See* the recommendation adopted by the OCDE on February 26, 1976.

[7] *See* FIBV Brochure (Paris, September 1978) which contains the full text of all resolutions and recommendations adopted by the FIBV.

[8] *See* O.J. Eur. Comm., No. 912/60, July 12, 1960; O.J. Eur. Comm., No. 62/63, January 22, 1963. The Third Directive concerning capital movement was prepared, but never formally adopted, by the Commission. In 1978 the Commission proposed the liberalization of transactions in connection with investment funds. *See* Monetary Committee Report for 1978, O.J. Eur. Comm. 1979, No. C 240/16.

[9] Directive of March 5, 1979, coordinating the conditions for the admission of securities to official stock exchange listing, O.J. Eur. Comm., No. L 66/21. February 16, 1979. For an extensive comment *see* Wymeersch, *La Directive sur les conditions d'admission en bourse*, Revue de la banque, (1980), Cahier No. 6.

[10] Prospectus Directive O.J. Eur. Comm., No. L 100/1; see also O.J. 1980, C 335/19.

[11] Proposal for a Directive concerning information to be published on a regular basis by companies whose transferable securities are admitted to official stock exchange listing, O.J. Eur. Comm. 1979, No. C 29/5; amended proposal O.J. 1980, No. C 210/5.

[12] Proposal for a Directive concerning coordination of laws, regulations and administrative provisions regarding collective investment undertakings for transferable securities, O.J. Eur. Comm. 1976, No. C 171/1.

[13] O.J. Eur. Comm. 1968, No. L 65/8; O.J. Eur. Comm. 1977, No. L 26/1; O.J. Eur. Comm. 1978, No. L 295/36; O.J. Eur. Comm. 1978, No. L 222/1.

[14] Proposals have been published for three other company law Directives: O.J. Eur. Comm. 1972, No. C 131/49; O.J. Eur. Comm. 1976, No. C 121/2 and 1979, No. C 14/2; O.J. Eur. Comm. 1978, No. C 112/6 and 1979, No. C 317/6.

[15] Although only the Admission and Prospectus Directives have been formally adopted, it can be stated that the overall integration scheme is, by and large, the same as the one upon which the Admission Directive is based.

[16] The scope of the powers of the EEC under the present Treaty is still the subject of debate. For an extensive interpretation *see* E.G.F. Marx, Funktion und Grengen der Rechtsangleichung nach art. 100 EWG-Vertrag (1976) at 48 et seq.

[17] Member States may not introduce subsequent legislation that would result in departure from the rules in a fashion contrary to the Directives. *See* the Simmenthal case, 1978, E.C.R. 629.

[18] The result in the United States was, however, achieved only after fierce battles were waged. Concerning the listing of New York Stock Exchange securities on regional stock

exchanges *see* Matter of the Rules of the New York Stock Exchange, 10 SEC 270 (1941). Concerning the trading of OTC securities on stock exchanges, *see* the dispute relating to "unlisted trading privileges," finally settled in 1964 (*cf.* L. Loss, Securities Regulation at 1132 *et seq.*), and more recently, the inclusion of listed securities in the NASDAQ over-the-counter trading system (*cf.* Securities Industry Study, Report of the Subcommittee on Securities, Committee of Banking, Housing and Urban Affairs, U.S. Senate, 93d Cong., 1st Sess., at 192 and 200).

[19] Only one foreign security is admitted to the Italian stock exchanges.

[20] *E.g.,* Admission Directive, art. 9; *see also* Admission Directive preamble.

[21] For a more detailed discussion *see* Wymeersch, *supra* note 9.

[22] Admission Directive, art. 5(*1*).

[23] The Directive's preamble indicates that the Directive does not intend to give issuers any right to listing. As regards the right to apply to the courts, it states that "such right ... must not be allowed to restrict the discretion of these authorities".

[24] *Cf.* Admission Directive, art. 9(3).

[25] Judicial scrutiny will be exercised to determine whether a "special condition" was based upon motives of investor protection.

[26] Admission Directive Schedule C, No. 6(a); Admission Directive Schedule D, No. A(5) and No. B(2).

[27] Admission Directive Schedule C. No. 6(b). This restriction may have been introduced in order to avoid the very extensive disclosures required by the SEC with respect to issues that have – at least in the opinion of the drafters of the Directive – no direct bearing on the financial value of the investment.

[28] The Directive contains no obligation to organize administrative control over these publications. It would be sufficient if some technique of enforcement were provided for, *e.g.* imposition of criminal or other sanctions.

[29] Among the many recent writings on this subject, *see* M. Marescau, De Directe Werking van het Europese Gemeenschapsrecht (1978) (to be published in English); A. Dashwood, *The Principle of Direct Effect in European Community Law,* 1979 J. Common Market Studies 229, 244; A. Easson, *Can Directives Impose Obligations on Individuals?* 1979 European L. Rev. 67; C. Timmermans, *Directives and their Effect within the National Legal Systems,* 16 Common Market L. Rev. 533 (1979).

[30] Enables members of the national control bodies to exchange confidential information without violating their traditional secrecy duties, but extends the legal protection of secrecy to all Member States.

[31] *See* declarations of Mr. Imbert, Director of the European Commission, *in* Committee to Review the Functioning of the Financial Institutions, Second Stage Evidence, vol. 1, at 79.

[32] It is not contended here that the harmonization directives are designed to bring about integration of the markets.

[33] For a recent survey *see* R. Lauwaars, *Auxiliary Organs and Agencies in the EEC,* 16 Common Market L. Rev. 369 (1979). Concerning doubts and questions raised with respect to the EMS, *see* M. Seidel, Das Europaische Währungssystem – Rechtliche Grundlage und Ausgestaltung, EuR (1979) at 13, which analyzes the question, which is also relevant with respect to the integration of securities markets, whether Article 235 of the Treaty contains a sufficient basis for the EMS.

[34] Articles 155 and 169 of the Treaty.

[35] *See* E. Wymeersch, *The Control of the Securities Markets in the EEC* in Commission of the European Communities, Series Competition (1978) No. 31 and No. 56 *et seq.*

[36] *See supra* note 29.

[37] Clearly other integration patterns besides the plan to be discussed could be designed. Thus, for example, rather than continuing with the present policy of multiple listings, Member States might prefer to adopt a scheme in which all orders would be channelled and concentrated on one of the Member State's stock exchanges, *e.g.* that stock exchange where the issuer

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is located or where the bulk of the transactions occur. There is no doubt that such an approach would be most unwelcome in the Member States, since, for some at least, this would mean an almost total disappearance of their securities markets. Furthermore, this would constitute a return to a nationalistic approach incompatible with the philosophy of the EEC.

[38] *E.g., see* Y. Flornoy, *Projets d'harmonisation et d'élargissement des marchés officiels en bourse dans la communité européenne in* L'avenir des marchés de valeurs mobilières (Journées d'Etudes 1976, Institut Universitatire International Luxembourg). *See also* AIBD, The Future Structure of the Securities Markets, Paris Conference, May 26, 1977; Dr. Mario Diana, Europe and the Stock Exchange: A Road Towards an Euro-Exchange, Lecture given at Fishmonger Hall on January 16, 1980.

[39] C. Tugendhat, *Orientations de la Commission européenne sur le rôle des bourses de valeur dans la CEE,* in Europe, Document no. 1083, January 29, 1980.

[40] J.M. Hessels, Vooruitzichten en problemen voor een geintegreerde Europese effectenmarkt, Bank- en effectenbedrijf (1972) at 462.

[41] *See also* E. Wymeersch, *supra* note 35.

[42] *E.g.,* admission disclosure, annual and interim disclosures, etc.

[43] This proposal is directly related to the question of the transmission of quotations which will be dealt with later.

[44] For example, some Member States (France, Italy and to a lesser extent Belgium) prohibit any principal or dealer activity in securities, while others (Luxembourg and Germany) allow orders coming from different directions to be set off within the same banking institution to be completed with orders held by other banks. Regardless of the technique used to execute the order, it would be reported to the Integrated Market System, with the *caveat* that order execution by way of setoff could not occur at more favorable prices than those prevailing on the market.

[45] Whether this would remain the sole method of trading securities in London will have to be analyzed separately since London brokers may prefer to be put on the same footing as brokers in other Member States who would be entitled to enter limit orders directly into the system themselves.

[46] *E.g.* in cases in which the quotation has already been hit by other market participants or the parties are still discussing a transaction initiated within the system.

[47] However, under present rules banks or "remisier" receiving orders from the public are not prevented from transmitting these orders abroad.

[48] Italy, Denmark, and to the extent that it relates to Eurobonds, this is also true for Luxembourg and the United Kingdom.

[49] For further discussion *see also* subsection 3.5 *infra.*

[50] Compare the procedures applicable pursuant to Articles 155 and 169 of the Treaty. *See also, supra* note 34.

[51] For a description of the CSI *see* Bank of England Bulletin (1979) no. 2.

[52] Another instrument of integration worthy of consideration is the organization of an appeal procedure before the Committee against certain decisions of the national control bodies concerning such matters as delistings and disciplinary proceedings.

[53] Handelsgesetzbuch §·400; *see also* Wymeersch, The Control of the Securities Markets in the Member States of the European Community, Part 1, no. 80 (to be published in English in 1980 by The European Commission in the Series "Competition").

[54] This implies that vis-à-vis the Integrated Market System these features did not become apparent and therefore that they would not affect the functioning of the market.

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