COMMENTS

COMPETITION IN THE EUROPEAN FINANCIAL SERVICES INDUSTRY: THE FREE MOVEMENT OF CAPITAL VERSUS THE REGULATION OF MONEY LAUNDERING

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1. INTRODUCTION

Over the past twenty years the level of international financial activity has skyrocketed as the world economy has become increasingly integrated. This increase of international financial activity is the result of the development of new communications technologies, the creation of international financial institutions and transactions aimed at escaping rigid domestic regulation,[1] and the adjustment of countries to the demise of the Bretton Woods system.[2] These trends and changes have required both private entities and national governments to become active participants in world capital markets.[3] Decisions about the country location of investment

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[1] *See* David C. Donald, *Toward a Single European Capital Market: The European Economic Community's Directive to Liberalize Capital Flows*, 20 LAW & POL'Y INT'L BUS. 139, 142-43 (1988).

[2] *See* PAUL SAMUELSON, ECONOMICS 619-620 (11th ed. 1980); WALTER JONES, THE LOGIC OF INTERNATIONAL RELATIONS 503-525 (6th ed. 1988). In 1971, the Bretton Woods system of fixed rate currency values, which was based on the United States' commitment to exchange dollars for gold at a one-to-one ratio, was abandoned in favor of the Smithsonian Agreement which created more or less freely floating exchange rates. While the change freed the United States from an obligation it found increasingly difficult to meet, the new system created a much higher risk of monetary instability in the world economy.

[3] "[T]ransnational corporations move capital around the world creating simultaneously capital deficits for the home accounts and improved overseas assets; governments use their reserves for both anticipating future

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and borrowing have increasingly become separated from decisions about the country location of real sector activity.[4] As a result, from 1964 to 1985, international banking grew at a compound rate of some 26% per year.[5] World financial flows are now 50 times larger than goods flows.[6]

The increased importance of capital manipulation[7] has created a potential competitive advantage for financial services companies based in countries with largely deregulated capital markets. One of the fundamental freedoms enshrined in the treaty creating the European Economic Community[8] is the free movement of capital.[9] While the elimination of barriers

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payments needs and purchasing their own currencies from foreign central banks in order to control their value and may also buy other currencies to affect their values." JONES, *supra* note 2, at 512.

[4] R.C. BRYANT, INTERNATIONAL FINANCIAL INTERMEDIATION 20 (1987) *quoted in* Donald, *supra* note 1, at 143. *Cf.*, Shari Siegel, *Slouching Toward Integration: International Banking Before and After 1992*, 11 CARDOZO L. REV. 147, 150 n.12 *citing* R. PECCHIOLI, THE INTERNATIONALISATION OF BANKING: THE POLICY ISSUES 16-24 (1983).

[5] "The comparable growth rates for trade and [real] output were, respectively, only about 12.5 and 10.5 percent." BRYANT, *supra* note 4, *quoted in* DONALD, *supra* note 1, at 143-44 n.23.

[6] BRYANT, *supra* note 4, at 150 n.12, *citing* Spero, *Guiding Global Finance*, 73 FOREIGN POL'Y 114, 114 (Winter 1988-89).

[7] As distinguished from capital movements based on real sector production.

[8] Treaty Establishing the European Economic Community, Mar. 25, 1957, 928 U.N.T.S. 11 (entered into force Jan. 1, 1958) (original version) [hereinafter EEC Treaty]. The purpose of the Treaty was to create a common market for goods, services, persons, and capital. *See id.* arts. 2, 3.

[9] *See* STANLEY CROSSICK & MARGIE LINDSAY, EUROPEAN BANKING LAW: AN ANALYSIS OF COMMUNITY AND MEMBER STATE LEGISLATION 9-10 (1983); MARC DASSESSE & STUART ISAACS, EEC BANKING LAW 109-111 (1985). Article 67(1) of the EEC Treaty provides the fundamental operative rule:

> During the transitional period and to the extent necessary to ensure the proper functioning of the common market, Member States shall progressively abolish between themselves all restrictions on the movement of capital belonging to persons resident in Member States and any discrimination based on the nationality or on the place of residence of the parties or on the place where such capital is invested.

Major provisions of other applicable articles are as follows:

Article 68 constrains Member States from discriminating when applying domestic rules regulating the capital market to capital movements liberalized pursuant to the Treaty.

Article 70 forms the legal basis for EEC law regarding coordination of exchange rate policies toward third countries by the Member States. The

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to the trade of goods has received the bulk of attention surrounding the creation of a European Common Market,[10] the establishment of the free movement of capital is an equally pivotal step in the creation of the internal market.[11] As the European Court of Justice[12] has noted, "[the] freedom to move certain types of capital is, in practice, a pre-condition for the effective exercise of other freedoms guaranteed by the Treaty."[13]

The fundamental goal of the free movement of capital is to provide Community residents and firms with the right "to invest within or borrow from residents [or institutions] of another Member State making use of all the techniques available under that Member State's financial system."[14] Under such a liberalized regime, the competitive structure of the financial services industry ("FSI") in Europe will be radically altered. Financial services will be delivered internationally with greater speed and efficiency, and with lower costs.[15] The exploitation of the competitive advantages

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provision seeks the highest level of liberalization possible.

Article 71 urges against the creation of any new exchange restrictions or the restrictive modification of any existing rules on capital movement.

Article 73 is an escape clause that allows Member States to take protective measures in the face of major disturbances in their domestic economies coming as a result of capital movements.

[10] *See* Peter Oliver & Jean-Pierre Bache, *Free Movement of Capital Between the Member States: Recent Developments*, 26 COMMON MKT. L. REV. 61, 61 (1989); J. Kodwo Bentil, *Free Movement of Capital in the Common Market-I*, NEW L. J., 963, 963 (Oct. 14, 1982).

[11] In fact, the liberalization of Europe's financial system has begun to have a significant catalyzing effect on the development of the internal market. "Finance is where project 1992 is moving most impressively forward—the business in which there is real progress towards the one-market ideal. This movement promises . . . to have the most telling impact on Europe's governments of any that the internal-market campaign will bring about by the mid-1990s." *1992; The Barriers Within*, ECONOMIST, July 9, 1988 (Special Section), at 15, 16.

[12] Article 177 of the EEC Treaty, *supra* note 8, empowers the European Court of Justice to make authoritative rulings on EEC law when an issue is referred to it by a court or tribunal of a Member State.

[13] Case 203/80, Public Prosecutor v. Guerrino; Preliminary ruling of 11 Nov. 1981 [1981] ECR 2595.

[14] Oliver & Bache, *supra* note 10, at 66; *see also* CROSSICK & LINDSAY, *supra* note 9, at 10.

[15] Siegel, *supra* note 4, at 152; *See also* Stanley Hoffman, *The European Community and 1992*, 68 FOREIGN AFF., Fall 1989, at 27, 28. ("European industrialists will achieve economies of scale that will allow them to operate

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produced by the free movement of capital will, in turn, further spur regional integration in Europe, a prerequisite to continued European competitiveness in the global market.[16]

The implementation of free capital movement in the EEC provides competitive advantages and opportunities for the FSI. The rise of illegal narcotics sales within the Member States and the attendant laundering[17] of large sums of money[18] are, however, threatening to restrict the ability of the European financial community to exploit the liberalized capital flows.

Saturation of the American market has spurred drug traffickers to attempt to expand the European market.[19] Initially, Spain proved an efficient point of entry for the Latin American drug cartels because of its common language and culture.[20] Following a crackdown by Spanish authorities in 1989, drug traffickers have now begun to adjust their routes

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more efficiently than if they were confined to their domestic markets . . ."); *EEC: Agreement on Free Circulation of Capital Goes Into Effect,* Inter Press Service, July 2, 1990 (Free movement of capital will reduce financial costs throughout the EEC as "a result of a greater competition on the part of banks in attracting new clients, as well as a reduction in the cost of money.").

[16] Hoffman, *supra* note 15, at 28, 29.

[17] The United Nations Draft Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, article 1, section (j) defines money laundering as "the concealment or disguise of the true nature, source, disposition, movement or ownership of proceeds and includes the movement or conversion of proceeds by electronic transmission." *See infra* notes 77-79 and accompanying text.

[18] A task force created by the Group of Seven (Canada, France, West Germany, Italy, Japan, the United Kingdom, and the United States) "estimates that profits from drugs and other criminal activities worth Dollars 80 bn are being laundered annually in the US and Europe." Robert Graham, *Limits on Bank Secrecy Proposed to Curb Laundering,* FINANCIAL TIMES, Apr. 12, 1990, at 1, 1.

[19] Stewart Tendler, *Plea for United Front to Stem Cocaine Imports,* THE TIMES (London), Apr. 10, 1990 (Home News section) at 3. *See also* Elizabeth Neuffer, *A Borderless Europe Beckons to Drug Traffickers,* BOSTON GLOBE, July 15, 1990, at 16, 16. The growth of the European drug market is reflected in the increase in cocaine seizures in Europe from 155 kilos in 1978 to nearly 5.5 tons in 1988. Richard Donkin, *Hurd Urges European Link-up To Confiscate Cocaine Profits,* FINANCIAL TIMES, May 19, 1989, at 6, 6.

[20] Elizabeth Neuffer, *Spain's Smugglers Turn to Cocaine,* BOSTON GLOBE, July 15, 1990, at 16, 16. (In 1988, 62% of all cocaine seized in Europe was found in Spain.).

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to make greater use of West Germany, France, the Netherlands, and the United Kingdom.[21]

The rapid growth of the illegal drug trade in Europe has raised the fear that "the conjunction of 1992's single market, drug trafficking, and money laundering could undermine the integrity of the financial system and disrupt financial markets."[22] In response to this specter, the European Council approved in June 1991 a "Council Directive on prevention of the use of the financial system for the purpose of money laundering."[23] The directive seeks to regulate the FSI with regard to financial transactions that are commonly or potentially part of money laundering schemes. The Money Laundering Directive is based in part on the belief that "the fight against drug money cannot be won without the help of banks."[24] However, in enlisting banks as the "first line of defense in the fight against drug[s],"[25] new duties have been placed on the financial community that may serve to dampen the competitive advantages produced by the liberalization of the movement of capital within the EEC.

The Member States are thus faced with a perplexing question: how can the EEC combat drug money laundering without unduly restricting the competitive advantages created for the European financial services industry by the free movement of capital within the Community?

This Comment begins by briefly setting out the present state of free capital movement in the EEC. Section II will define the EEC FSI and analyze the effect of the free movement of capital on the competitive structure of the industry. Section III will provide an overview of common money laundering techniques and will examine how the Money

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[21] Tendler, *supra* note 19. (The Spanish law enforcement efforts netted the arrest on cocaine smuggling charges of 2,000 people from 70 countries during 1989.).

[22] Bruce Zagaris & Markus Bornheim, *Cooperation and Fight Against Money Laundering in Context of European Community Integration*, 54 BANKING REP. (BNA) No. 3 at 119 (Jan. 22, 1990).

[23] Council Directive 91/308, 1991 O.J. (L 166) 77 [hereinafter Money Laundering Directive].

[24] Interpol Secretary General Raymond Kendall speaking before the French Banking Association on April 18, 1990, *quoted in* BNA DAILY REPORT FOR EXECUTIVES, Apr. 19, 1990, der no. 76, at A7.

[25] *Id.*

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Laundering Directive will serve to defeat many of the competitive advantages produced by the free movement of capital between the Member States. A brief conclusion will close the Comment.

2. FREE MOVEMENT OF CAPITAL

During the early 1980s a series of Council Directives were passed that focused on capital *qua* capital,[26] rather than on capital movements as by-products of trade in goods.[27] Out of

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[26] In traditional financial theory, capital represents debt or equity available for investment.

Donald, *supra* note 1, at 140 (citations omitted), provides the following representative list of transaction types commonly encompassed within the scope of capital movements:

> (1) changes in bank claims vis-a-vis foreigners; (2) money market transactions of non-residents; (3) new bond issues by nonresidents; (4) transactions in existing securities (trading in company securities and government issues); and (5) direct investment flows . . . The movements are both long and short term, and, except for bank claims which are often associated with the international sale of goods, they are independent of real sector trade.

Despite its recognition of the free movement of capital as a fundamental freedom, the EEC Treaty fails to define either "capital" or "movement of capital." Major European Court of Justice cases involving the definition of these terms include *Casati*, *supra* note 13; Joined Cases 286/82 and 26/83 Luisi and Carbone v. Ministero del Tesoro, Preliminary Ruling of 31 January 1984, 1984 ECR 377; Case 7/78 Regina v. Thompson, Johnson, and Woodiwiss, Judgment of 23 Nov. 1978, 1978 ECR 2247. *See also* Oliver & Bache, *supra* note 10; Donald, *supra* note 1; DASSESSE & ISAACS, *supra* note 9; J. Kodwo Bentil, *Free Movement of Capital in the Common Market-II*, NEW L. J. 1049, 1049 (Nov. 11, 1982); Jean-Victor Louis, *Free Movement of Capital in the Community: The Casati Judgement*, 19 COMMON MKT. L. REV. 443 (1982). The court came closest to providing a straightforward definition of capital movements in *Luisi* when it wrote, "movements of capital are financial operations essentially concerned with the investment of the sum in question and rather than remuneration or a service."

For further discussion of what constitutes capital and capital movement see the discussion of the Nomenclature of the Capital Movements Directive and the section on the definition of the FSI *infra* section *3.1.*

[27] The first progress toward free capital movement was seen in Directive 85/583/EEC, promulgated in December 1985, which liberalized a single category of transactions (operations involving certain types of unit trusts).

In November 1986, Council Directive 86/566, 1986 O.J. (L 332) 22 amended the First Directive for the implementation of Article 67 of the Treaty of 11 May 1960 (Council Directive 43/921, 1960 O.J. (Spec. Ed.) as amended) (for a description of the First Directive and its original amendment, see DASSESSE & ISAACS, *supra* note 9, at 111-112; Oliver & Bache,

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the debate surrounding these Directives three principles emerged that became the basis for the ultimate liberalization of capital movements:

> First, the creation of a single financial market requires . . . free movement of capital.[28] . . . Second, the freedom to provide financial services should not be based upon standardisation of products offered but rather on harmonisation of the main prudential rules applying to those supplying services so as to permit mutual recognition of national provisions and home country control. Third, any attempt to subject all progress towards liberalisation of capital movements to the prior harmonisation of national financial systems would have the effect of arresting the process of financial integration.[29]

The Council of the European Communities[30] took the final

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supra note 10, at 63-65; F. BURRÒWS, FREE MOVEMENT IN EUROPEAN COMMUNITY LAW 274-279 (1987)). Directive 86/566 implemented the first phase of a two-stage liberalization program by transferring from a conditionally liberalized status to an unconditionally liberalized status a number of basic transactions, including liberating long-term commercial credits, transactions in over-the-counter securities, and guaranteeing that any shares presently traded or being introduced on the securities exchange of a Member State would be admitted for trade to the exchange of another Member State. The new Directive also created uniform rules for two sets of transactions that had previously been treated separately: (1) direct investments and investments in real estate, personal capital movements, short- and medium-term credits in respect to commercial transactions or the provision of services; and (2) acquisition by residents of foreign securities dealt in on a stock exchange or the converse (i.e., acquisition by non-residents of domestic securities dealt in on a stock exchange).

With the adoption of Directive 86/566, the "second phase" of liberalization aimed at the unconditional liberation of all international capital transactions was begun. *See* Oliver & Bache, *supra* note 10, at 65-67; Donald, *supra* note 1, at 141, 147. This second phase was to be completed with the full implementation of Directive 88/361, see text and notes *infra* at p. 10.

[28] Oliver & Bache, *supra* note 10, at 66, have defined "free movement of capital" as "the right of a resident of a Member State to invest within or borrow from residents of another Member State making use of all the techniques available under that Member State's financial system."

[29] *Id.*

[30] In order to achieve the creation of a common market in Europe, the Treaty of Rome, buttressed by national legislation in each of the Member States, established a legal order vesting legislative

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step on this path when it adopted the "Directive of 24 June 1988 for the implementation of Article 67 of the Treaty."[31] The Capital Movements Directive repealed the existing rules on capital movements[32] and decreed that its terms, which fully liberalized capital movements among Member States, were to be implemented by July 1, 1990.[33] The directive is "the basis of the entire financial services liberalization process."[34] To this end, article 1 of the Capital Movements Directive declares that "Member States shall abolish restrictions on movements of capital taking place between persons resident in Member States." As an aid in this process, Annex I of the Directive provides a Nomenclature of the capital

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> competence in Community institutions [e.g., the Council of the European Communities]. These institutions would enact supranational law to 'harmonise' regulation in Member States thereby removing impediments to a single market. The form of legislation most commonly used to achieve this end is the Directive [EEC Treaty art. 100, *see also* arts. 189-192]. A Directive requires the Member States to adopt legislation intended to achieve specified objectives within a set period of time, usually two years from the date of the Directive. Although Directives require implementing legislation in the Member State, the form and method of implementation is left to the discretion of the government of each Member State. [EEC Treaty art. 189].

DAVID BARNARD, THE EFFECT OF 1992 ON THE EUROMARKETS, CORPORATE LAW AND PRACTICE COURSE HANDBOOK SERIES: NEW FINANCIAL INSTRUMENTS AND TECHNIQUES 1989, point 2 (1989).

Even if a directive is not implemented by a Member State by the appointed date, it may provide rights to individuals that are enforceable by the national courts. *See* CROSSICK & LINDSAY, *supra* note 9, at 6.

[31] Council Directive 88/361, 1988 O.J. (L 178) 5 [hereinafter Capital Movements Directive].

[32] Specifically, Council Directive 88/361 repealed as of July 1, 1990 the First Council Directive on Capital Movements of 11 May 1960 (Council Directive 43/921, 1960 O.J. (Spec. Ed.)) as amended and Council Directive 72/156, 1972 O.J. (Spec. Ed.) (L 91) 13.

[33] *See* article 6(1). Article 6(2) authorizes Spain, Portugal, Greece, and Ireland to maintain certain restrictions until the end of 1992 to ease the transition to a fully liberalized system. Article 6(3) and Annex V allow Belgium and Luxembourg to continue to operate dual exchange markets until December 31, 1992, with the caveat that the exchange rate rulings on the two markets exhibit no great or lasting differences.

[34] Annabelle Ewing, *The Single Market of 1992: Implications for Banking and Investment Services in the EC*, 13 HASTINGS INT'L & COMP. L. REV. 453, 454 (1990).

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movements referred to in article 1 of the Directive.[35] Transactions that had formerly been restricted and are now liberalized include financial loans and credits, current and deposit account operations, and transactions in money market securities.[36] Moreover, the Directive makes it clear that "this [liberalization] requirement entails not only the abolition of foreign exchange restrictions as such (i.e., measures prohibiting or restricting transfers relating to capital movements) but also the removal of all obstacles to the execution of the capital transactions themselves."[37] In short, the Directive gives financial service firms free access to the financial system of any Member State "whether this access be in the form of a multi-billion [European Currency Unit] bond issue or a simple checking account."[38]

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[35] While the Annex explicitly states that the Nomenclature is "not an exhaustive list for the notion of capital movements," and thus should not be read to restrict the "scope of the principle of full liberalization of capital movements," the Nomenclature and the explanatory notes that accompany it largely clear up lingering questions as to the definition of "capital movements."

The Nomenclature breaks capital movements into thirteen broad categories which are individually defined: I. Direct Investments; II. Investments in Real Estate; III. Operations in Securities Normally Dealt in on the Capital Market; IV. Operations in Units of Collective Investment Undertakings; V. Operations in Securities and Other Instruments Normally Dealt in on the Money Market; VI. Operations in Current and Deposit Accounts with Financial Institutions; VII. Credits Related to Commercial Transactions or to the Provision of Services in which a Resident is Participating; VIII. Financial Loans and Credits; IX. Sureties, Other Guarantees and Rights of Pledge; X. Transfers in Performance of Insurance Contracts; XI. Personal Capital Movements; XII. Physical Import and Export of Financial Assets; XIII. Other Capital Movements.

[36] The complete move away from viewing capital movements as mere adjuncts to the trade in goods is exhibited by the fact that the Directive fully liberalizes long-term bond issues and bank financing, as well as trade in instruments normally exchanged on the money market, including short-term securities, treasury bills and other negotiable bills, certificates of deposit, bankers' acceptances, commercial paper, and other like instruments. Capital Movements Directive, *supra* note 31, at 12.

[37] Oliver & Bache, *supra* note 10, at 68.

[38] Donald, *supra* note 1, at 148. The Capital Movements Directive is also "supplemented by a regulation establishing a single facility providing medium-term financial support for Member States' balances of payments." EEC Council Regulation No. 1969/88 of 24 June 1988 establishing a single facility providing medium-term assistance for Member States' balance of payments. 1988 O.J. (L 178) 1. This regulation "enables the Council to grant loans to Member States which face difficulties in their balance of

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The sweeping liberalization instituted by the Capital Movements Directive leaves open questions concerning the extent to which Member States retain power in the regulation of capital flows. Generally, "Member States retain responsibility for the actions of monetary policies and . . . for the internal organisation of their capital and credit markets, unless provisions adopted at Community level regarding monetary cooperation or harmonisation of national rules dictate otherwise."[39] Article 3 also contains a safeguard clause that allows Member States, after consultation with the Commission in most cases, but unilaterally in the case of a crisis, to restrict short-term capital movements for up to six months if monetary or exchange-rate policies are disrupted.[40]

While the two provisions noted above are fairly straight forward, Article 4 leaves unresolved the exact amount of power the EEC has to act within individual Member States to protect the free movement of capital. Under Article 4, Member States retain the power to "take all requisite measures to prevent infringements of their laws and regulations . . . or to lay down procedures for the declaration of capital movements for purposes of administrative or statistical information."[41] Such provisions are not, however, to impede capital movements that occur in keeping with Community law. As the new Directive has so recently gone into effect, there is no case law to offer any guidance as to how the EEC will mediate disputes over individual an Member State's use or abuse of power over capital movements.

The original proposal introducing the Capital Movements Directive[42] does, however, offer an indication of the parame-

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current payments or capital movements." Panagiotis Tridimas, *Movement of Capital and the Law Relating to Companies and Trade in Securities*, 38 INT'L & COMP. L. Q. 214, 215 (Jan. 1988).

[39] Oliver & Bache, *supra* note 10, at 69.

[40] Annex II to the Capital Movements Directive, *supra* note 31, at 12, provides a "list of operations referred to in Article 3 of the Directive." Annex II notes that "[t]he restrictions which Member States may apply to the capital movements listed above must be defined and applied in such a way as to cause the least possible hindrance to the free movement of persons, goods and services."

[41] *Id.* at 6.

[42] Creation of an European Financial Area, COM(87) 550 final [hereinafter Commission Doc.].

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ters within which Member States exercise such authority. According to the introductory document, Member States will be required to enforce their regulatory schemes against domestic and other Member States' individuals, firms, and transactions without discriminating.[43] A Community resident using the financial services of a Member State not his or her residence will, in turn, be blocked from invoking the rules of his or her home country as protection against the regulations of the State in which he or she is conducting business. Finally, de facto discrimination arising from domestic regulations will be allowed toward foreign financial institutions, provided that the regulations do not inhibit the institutions' ability to provide financial services, but rather only affect such areas as exchange rates. The purpose of this exception is to protect against a foreign branch institution causing currency fluctuations within a Member State as a result of the institution's manipulation of large volumes of foreign exchange.[44]

3. THE EEC FSI AND THE COMPETITIVE EFFECT OF FREE CAPITAL MOVEMENT

The financial services area has not been traditionally thought of as an industry, nor as an international entity, nor has it been believed to be particularly competitive on a global scale. The liberalization of capital movement in the EEC, combined with broader changes in the world economy, however, has changed the traditional structure and function of financial services. Today, financial services in Europe and elsewhere are delivered by a highly competitive global industry. The introduction of free capital movement will continue to significantly affect the competitive structure of the industry.[45]

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[43] *Id.* at 15.

[44] *See* Donald, *supra* note 1, at 149.

[45] The theoretical basis for this section of the Comment is Harvard Business School Professor Michael E. Porter's 1980 study COMPETITIVE STRATEGY: TECHNIQUES FOR ANALYZING INDUSTRIES AND COMPETITORS.

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3.1. Definition and Structure of FSI in the EEC

In its directives the European Council has legally defined the FSI as consisting of two components: (1) credit institutions which are defined as "undertaking[s] whose business is to receive deposits or other repayable funds from the public and to grant credits for [their] own account[s];"[46] and (2) financial institutions which are defined as undertakings other than credit institutions whose principal activity is to carry out one or more of the following operations:

1. lending (including *inter alia* consumer credit, mortgage credit, factoring, with or without recourse, and financing of commercial transactions)
2. financial leasing
3. money transmission services
4. issuing and administering means of payment (e.g., credit cards, travellers' checks, and bankers' drafts)
5. guarantees and commitments
6. trading for own account or for account of customers in:
   a. money market instruments (checks, bills, CDs, etc.)
   b. foreign exchange
   c. financial futures and options
   d. exchange and interest rate instruments
   e. transferable securities
7. participating in share issues and the provision of services related to such issues
8. advising undertakings on capital structure, industrial strategy and related questions and advice and services relating to mergers and the purchase of undertakings
9. money broking
10. portfolio managing and advising
11. safekeeping and administrating securities
12. safe custody services.[47]

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[46] First Council Directive of 12 December 1977 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions, Council Directive 77/780, art. 1, 1977 O.J. (L 322) 30.

[47] This list of operations derives from the list annexed to Council Directive 89/646, 1989 O.J. (L 386) 1.

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As a legal construct, therefore, the FSI covers a wide array of specifically defined activities.

As a practical business construct, companies providing financial services function as a single industry[48] that encompasses all the activities of both credit institutions and financial institutions, as well as the activities of insurance companies. The FSI employs three percent of the EEC's workers and accounts for six percent of its pay.[49] The raw material of the industry is capital. Capital is packaged for "sale" in myriad products, including initial public offerings, savings accounts, life insurance policies, letters of credit, and many forms of loans (e.g., consumer loans, mortgage loans, commercial loans).

Financial services firms traditionally filled these needs, and thus competed, almost solely within domestic markets. As capital movements rather than trade have increasingly become the driving force behind the world economy, however, a shift in the focus and delivery of financial services has begun to take place.[50] The growth of truly global industries[51] has

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[48] An industry can be generically defined as a group of companies creating products that are close substitutes for each other.

[49] *1992; The Barriers Within*, *supra* note 11, at 16.

[50] Peter F. Drucker, *The Changed World Economy*, 64 FOREIGN AFF. , 768, 782 (Summer 1986):

> World trade in goods is larger, much larger, than it has ever been before. And so is the 'invisible trade,' the trade in services. Together, the two amount to around $2.5 trillion to 3 trillion a year. But the London Eurodollar market, in which the world's financial institutions borrow from and lend to each other, turns over $300 billion each working day, or $75 trillion a year, a volume at least 25 times that of world trade.
>
> In addition, there are the foreign exchange transactions in the world's main money centers in which one currency is traded against another. These run around $150 billion a day, or about $35 trillion a year—12 times the worldwide trade in goods and services.
>
> Of course, many of these Eurodollars, yen and Swiss francs are just being moved from one pocket to another and may be counted more than once. A massive discrepancy still exists, and there is only one conclusion: capital movements unconnected to trade—and indeed largely independent of it—greatly exceed trade finance.

[51] PORTER, *supra* note 45, at 275, defines a global industry as "[an industry] in which the strategic positions of competitors in major geographic or national markets are fundamentally affected by their overall global positions . . . [these firms must] compete on a worldwide, co-ordinated basis or face strategic disadvantages." A global industry can, thus, be distin-

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forced goods and services producers to take into account factors that do not affect domestic entities: factor cost differences among countries (e.g., comparative labor costs and labor productivity, raw material costs, energy costs, transportation costs); differing circumstances in foreign markets; different roles of foreign governments; and differences in goals, resources, and ability to monitor foreign competitors.

Traditional economic theory would hold that these "real" economic factors would combine to determine exchange rates. In reality, however, the decoupling of the "real" economy from the "symbol" economy[52] has increasingly caused financial factors to determine how production costs in country A compare to production costs in country B.

As purely financial concerns have become more important and more manipulable, "[a]ny firm exposed to the international economy has to realize that it is in two businesses at the same time. It is both a maker of goods (or a supplier of services) and a 'financial' business."[53] A business can no longer simply decide whether or not to borrow or to raise equity capital; the business must now ask,

> [s]hould the debt be at a fixed or a floating rate? In which currency? When should these decisions be changed? Should an instrument come with an option attached allowing investors to buy or sell at particular prices? Is it worth paying a fee to have a cap or floor put on the interest rate?[54]

In order to exploit the need of companies to manage global financial concerns, FSI firms have had to shift their focus from trade-bound domestic financial transactions to world capital markets per se.[55] In doing so, it has become a strategic

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guished from an international industry, which contains companies that function in many different countries, but which do so through basically autonomous subsidiaries that compete independently in each domestic market.

[52] Drucker, *supra* note 50, at 781, defines the symbol economy as "capital movements, exchange rates and credit flows." *See also* text *supra* at note 4.

[53] Drucker, *supra* note 50, at 787.

[54] *Backward, and Yet Forward*, ECONOMIST, Apr. 27, 1991 (Survey: International Finance), at 7.

[55] A similar conclusion can be applied to the EEC itself. *See* Donald, *supra* note 1, at 141.

imperative that the various sub-entities of an FSI organization function seamlessly, and not as independent fiefdoms concerned with only one domestic reality. However, "providing cross-border services is virtually impossible [if an organization is faced with] the existence of exchange control restrictions and discriminatory national fiscal provisions."[56]

3.2. Free Capital Movement as Global Competitive Advantage for the FSI

As an integrated world economy continues to evolve, the number and variety of truly global industries will rise. In order to provide adequate financial services to these industries, the FSI itself will be forced to become global. Both FSI firms and their global clients have to be particularly aware of a number of strategic factors, including foreign competitors, a broader pool of potential entrants, a wider range of possible substitutes, and the continued likelihood that cultural differences will produce dissimilar goals and competitive strategies for individual firms within the same industry.

While the FSI exhibits a high degree of innovation, over time financial products become largely fungible from firm to firm. Thus, competition within the FSI, while influenced in

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A concrete example of the EEC's new focus on the importance of capital was the creation of the European Monetary System ("EMS"). Fearing the effects capital market fluctuations would have on their trade and balance of payments, the EC established in 1979 the EMS through which member states pool part of their gold and foreign currency reserves. While all twelve EC members (Germany, France, Italy, Denmark, the Netherlands, Ireland, Belgium, Luxembourg, Spain, Britain, Portugal, and Greece) belong to the EMS, the exchange rate mechanism ("ERM") of the EMS did not originally include Britain, Portugal, or Greece. Britain joined the ERM in October 1990. The ERM acts as a managed float system; fluctuations of exchange rates are contained within a narrow, pre-determined band by members valuing their currencies using a combination of raising or lowering their respective interest rates, by buying and selling each others' currencies or by adjusting their fiscal policies (e.g., changing tax rates). The EMS has functioned to reduce inflation in Europe and to influence member governments to follow similar (if not yet truly coordinated) fiscal and economic policies. Because Britain declined to join the exchange rate mechanism of the EMS at its inception, the system has been largely tied to the value of the Deutsche mark and West Germany's policy of monetary stability has become the European norm. *See* JONES, *supra* note 2, at 511; Hoffman, *supra* note 15; *What the ERM Really Means*, THE SUNDAY TIMES (London), Oct. 7, 1990.

[56] Ewing, *supra* note 34, at 453.

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the short-term by innovation, is driven in the long-term by the efficiencies firms develop in delivering and servicing their products. The free movement of capital does away with many transactional costs and barriers, allowing more efficient delivery of financial services. The FSI in Europe is consequently faced with a significant competitive opportunity following the implementation of free capital movement.

3.2.1. Comparative Advantage

A comparative advantage exists when a country or countries provide substantial advantages in factor cost, government regulation, location, and the like.[57] The competitive posture of the global firm in countries possessing a comparative advantage is crucial to its overall competitive position.

The comparative advantage of free capital movement can be illustrated in reverse by the experience of the United States in the early 1960's. At that time, the United States dominated the international financial markets. However, the imposition of "the Interest Equalization Tax ("IET") and the Foreign Credit Restraint Program ("FCRP") drove many international financial transactions out of the United States and gave birth to the eurodollar[58] markets."[59] While to conclude that the United States catalyzed the growth of the European financial markets solely as a result of its regulatory activity is too facile, the exodus of capital from the United States to Europe demonstrates that a lack of capital regulation can act as a strong comparative advantage.

A second illustration of the comparative advantage that the free movement of capital provides the EEC FSI is the increasing securitization of international capital flows.[60] While, in the past, a capital consumer's only recourse for raising funds was a commercial bank, external financing now often occurs through the issuing of marketable securities. The linkage of the various European securities markets through the free movement of capital creates a viable competitive alternative to

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[57] Two of the most easily recognized comparative advantages in the FSI are banking secrecy and lenient tax laws.

[58] A eurodollar is a United States dollar held outside the United States.

[59] Donald, *supra* note 1, at 139.

[60] *See id.*, at 144.

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United States and Japanese markets, and "[i]n the financial sphere, the attractiveness of an integrated whole is much greater than the sum of its component parts."[61]

The comparative advantage of free capital movement is particularly clear in relation to exchange rates. "[T]he abolition of exchange control restrictions in the Member States is the first step toward . . . mak[ing] the integration of banking and investment services a reality in the EC. The existence of such restrictions effectively prevents . . . companies from freely transferring or holding financial assets."[62] The elimination of exchange control restrictions frees the FSI from domestic political concerns and their effect on the regulation of exchange rates. Moreover, the industry may more accurately

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[61] EEC Press Release IP(86) 556, Nov. 17, 1986, at 2 *quoted in* Donald, *supra* note 1, at 144. This point is particularly borne out by the United States, which possesses the largest unified economy in the world, but is hampered by the split in the FSI engendered by the Glass-Steagall Act which decrees that investment banking functions and commercial banking functions cannot be undertaken by the same firm. "The U.S. must take active steps to eliminate the current balkanization of American banking if it is to meet the new European challenge in the financial services market." Siegel, *supra* note 4, at 152.

[62] Ewing, *supra* note 34, at 454. It is not surprising that nations are reluctant to give up control of exchange rates. The value of a country's currency will determine the price of imports to and exports from that country. The implications of this simple concept are profound:

> If, for example, the rise of the dollar's value makes American-built machinery so expensive internationally that consumers turn to German or French imports . . . then the machine tool industry in the United States will be adversely affected. Fewer units will be exported, and because the overall production level was set with the assumption that exports represented productivity in excess of domestic demand, buyers at home will not be able to consume those units that are no longer exported. Results: Production goes down; investment is curtailed; income is reduced; employees are released; and plants may be closed. But the ramifications run still deeper: The loss of income results in reduced bank deposits, a decline in capital accumulation, and a reduction of investment in other industries. Meanwhile, both the industry and the unemployed workers pay less to tax revenues—the source of public investment—commensurate with their lost income. In fact, the workers may now draw subsistence from public welfare . . . transforming them into financial liabilities for public revenue. Hence as public revenue declines, public expense rises, and changes are forced upon the distribution of the public treasury. The variation in currency value has now resulted in social and economic changes at home.

JONES, *supra* note 2, at 505.

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control its currency positions for the purposes of risk management and investment.

3.2.2. *Economies of Scale*

The EEC FSI will gain production economies of scale[63] from the free movement of capital; once a firm from one Member State develops a particular financial product or service, the common regulatory environment produced by the free capital movement system will make its application in the other Member States far less difficult and less expensive than in the past. Today, this advantage holds particularly true for currencies, commodities, and government and corporate bonds.[64] Economies of marketing and research and development will be achieved through free capital movement because the larger EEC market will allow a financial services firm to sell a higher volume of each product developed and thereby more easily recoup its development and marketing costs. Moreover, a larger market allows the fixed costs of creating and maintaining an organization to be spread across a larger customer base.

3.3. *Impediments to Achieving Competitive Advantages from the Free Movement of Capital*

Despite the benefits described above, there are a number of impediments which may offset the advantages of competing on the global level.[65]

One significant hindrance confronting the FSI is the need to gain access to distribution channels in each domestic

[63] "Economies of scale are enjoyed when the average unit cost of production goes down as production increases. One way to achieve economies of scale is to spread fixed costs over a larger volume of production." BREALEY AND MYERS, PRINCIPLES OF CORPORATE FINANCE 796, n.5 (3rd ed., 1988). In addition to production, common areas in which economies of scale can be derived include marketing, research and development, and purchasing.

[64] Note, however, that diverse domestic legal systems, tax systems, and accounting practices create more impediments for cross-border flows of equities. *See Backward, and Yet Forward, supra* note 54, at 7.

[65] Obstacles commonly cited for many global industries include high transportation and storage costs, the need for local repair services, and a lack of global demand. None of these factors apply, however, directly to the FSI.

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market. In reality, this obstructs only some parts of the FSI. For example, a bank that wishes to compete for retail business throughout Europe will be forced either to acquire existing retail outlets or create new outlets as a way of distributing its products. Financial services firms that deal in the institutional or commercial market, however, have less need to maintain large physical presences in each national market. Modern communications technology and the market savvy of capital consumers will combine to bring customers to the firms maintaining the best competitive posture, regardless of whether they maintain a significant physical presence in the customer's home market.[66] Free movement of capital, therefore, is a key component in overcoming distribution needs as an impediment, as it reduces, for at least some segments of the FSI, the need for "local" distribution.[67]

The domestic structural restraints imposed on the industry, however, are broader and more fundamental deterrents to the true globalization of the FSI. Almost every national market is riddled with governmental impediments to global competition. These institutional barriers include differing tax laws, accounting practices, fiduciary rules, insider trading standards, and tariff barriers. Such institutional restraints reduce the advantage produced by global economies of scale by forcing firms to retool their products to fit each national market. As noted above, these impediments are more problematic for the cross-border flow of equities than for the trading of currencies, commodities, and bonds.

In a sense, this issue of governmental impediments to competition is the essence of why the EEC was created, that is, to form a single European standard that would foster free competition, rather than 12 separate and often conflicting domestic standards. The EEC FSI will only continue to gain

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[66] Recall the contention that investing/financing and real production have become increasingly decoupled as international capital markets have matured. *See* notes 17-18 and accompanying text.

[67] The same analysis applied here to local distribution channels can be applied to the need for a local sales force. In most cases, a salesperson on the phone in London selling bonds to an investor in France is as effective as a local French salesperson pushing the same sale. Again, the more sophisticated the capital consumer, the more important the quality of the financial product and the less vital the physical location or national identity of the financial services firm.

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competitive advantages as tax laws, accounting standards, and reporting requirements become increasingly uniform. The removal of governmental impediments to capital movements permits the EEC FSI to function on a scale and with a flexibility heretofore unknown in the world. This systemic change will create demand among capital consumers for an increasingly deregulated, or at least increasingly uniform, financial system that will hasten the completion of the European internal market. The more similar national markets become in their economic and cultural circumstances vis-a-vis the FSI, the greater the potential for free competition worldwide as other markets are forced to deregulate their financial systems in response to the comparative advantages found in the EEC market.

3.4. Competitive Concerns and Trends in the FSI

3.4.1. Competitive Concerns

A constant concern of the FSI is the relationship between the industry and the governments of the countries in which the industry functions. "The two have complex relationships which can involve many forms of regulation . . . Home governments [also] often have objectives, such as . . . balance of payments, that are not strictly economic, certainly from the point of view of the firm."[68] Governmental policies directly influence the FSI. Changes in tax law, shifts in monetary policy, or alterations in reporting requirements will all drastically affect the FSI's competitive structure in a given country. Most often the FSI has little control over the plethora of domestic political and economic factors, as well as international concerns, that produce government policies.[69] The creation of free capital movement insulates to some extent the FSI from the vagaries of home government politics; the regulation of capital can no longer act as a domestic bargaining chip in determining the policies of a Member State. This affords the FSI the ability to make long-term commitments

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[68] PORTER, *supra* note 45, at 291.

[69] The FSI is able to exert some influence on government policies through lobbying, campaign contributions, and the flow of industry executives into and out of government service. The effect of these influences is relatively small, however, when a firm is operating in a foreign country.

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and conduct strategic planning in a regulatory environment that offers some level of stability.

The free movement of capital both exacerbates and mitigates the FSI's concern regarding the coordination of global patterns of investments, market positions, and facilities. The ability to move capital without restraint gives the FSI unparalleled flexibility in reacting to and taking advantage of shifts in European capital markets. At the same time, the lack of regulation may serve to transmit shocks through the European financial system at much greater speeds and without any dampening effects.[70] Consequently, "in maintaining a competitive balance from a systemic viewpoint, it may be necessary for firms to make defensive investments in particular markets and locations."[71] The free movement of capital will coincidentally enhance the speed and precision at which the management of such defensive posturing can occur. In addition, the defensive investments will help further integrate Europe as a true common market, thereby furthering the EEC Treaty's goals.

3.4.2. Competitive Trends

Two emerging trends are of great importance for competition within the FSI. First, "[t]he economic differences among developed and newly developed countries may be narrowing in areas like income, factor costs, energy costs, marketing practices, and distribution channels."[72] If this trend continues, the FSI will have enormous opportunities to develop new markets and exploit previously underdeveloped economic systems. Within the EEC itself, the free movement of capital will provide the FSI with a great deal of room to expand into and help develop the economies of Greece, Portugal, and southern Italy, economies that traditionally have lagged behind their more developed EEC counterparts.

The minimization of the differences among the financial systems of the various Member States is a prerequisite to fully

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[70] For example, a sudden stock market collapse in a single Member State could precipitate a wide-spread failure of stock markets within the Common Market.

[71] PORTER, *supra* note 45, at 293.

[72] *Id.* at 295.

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realizing the advantages of the free movement of capital. Unfortunately, as the EEC continues to evolve toward a truly unified internal market, some commentators "anticipate[] that pressure from Member States with highly regulated markets will eventually restrict deregulation to . . . minimum levels . . . ."[73] The success of the free capital movement system, therefore, may depend on another Council Directive proposed in 1988.[74] Under article 5 of the proposed directive, banks would be able to obtain from their home country authorities a single license valid throughout the EEC. Thus, "a bank established in any member state will be able to branch throughout the EC without further authorization from the host states."[75] The single license would free individual institutions from the highly influential special interest groups within each individual Member State, and would allow the free movement of capital to be used as a true competitive advantage.

The second emerging trend confronting the FSI is the gradual emergence of new large-scale markets. China, India, and Eastern Europe are all vast markets that have heretofore been largely untouched by the development of the Western industrialized economy. The growth of these markets will depend to a large degree on the effective marshalling of Western capital markets. The massive pool of capital created by the realization of the Common Market offers the EEC FSI significant competitive opportunities to exploit these emerging mega-markets.[76] The free movement of capital will enable goods and services producers to employ financing in the most efficient manner to capitalize on the new large scale markets.

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[73] Ewing, *supra* note 34, at 460. Contrary opinion would hold that in fact the advantages of deregulation in some countries will force the more regulated countries to relax their restrictions, a kind of "lowest common denominator" of regulation concept.

[74] Commission Proposal for a Second Council Directive on the Coordination of Laws, Regulations and Administrative Provisions Relating to the Taking-Up and Pursuit of the Business of Credit Institutions and Amending Directive 77/780/EEC, 1988 O.J. (C 84) 1 [hereinafter Second Directive]. *See* Siegel, *supra* note 4, at 161.

[75] Siegel, *supra* note 4, at 161.

[76] The EEC is itself an emerging large-scale market which, as noted above, provides the FSI with many competitive opportunities close to home.

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4. MONEY LAUNDERING AND ITS EFFECT ON THE COMPETITIVE ADVANTAGE OF FREE CAPITAL MOVEMENT

4.1. Common Money Laundering Practices

The United Nations recently released a report which calculated that the world trade in illicit drugs has grown to $500 billion per year. According to the report, drugs may have surpassed oil as the second largest commodity in world trade; only the arms trade now has a higher turnover rate than the trade in drugs.[77] Moreover, "cocaine is . . . clearly the most profitable article of trade in the world."[78] In order to take advantage of the drug trade's enormous profits, however, traffickers must transform large amounts of illegally obtained currency into readily available and untraceable "clean" assets. In particular,

> [t]he world's biggest consumers of money-laundering services are Latin American drug smugglers. Their domestic economies cannot absorb the cash their international trade generates; like multinational companies, a big part of their earnings accrue overseas and, like good businessmen, they want to diversify and invest abroad in legitimate businesses . . . . For that, they need to blot out the connection between that globetrotting money and the crime that made it.[79]

Money laundering techniques have traditionally involved passing illegal currency through a domestic cash business (e.g., a restaurant or casino) and reporting the profits as legal income from that legitimate activity. Disguising the connection between money and crime has become increasingly difficult, however, as the sheer amount of money that drug traffickers handle has outstripped their ability to use domestic laundering outlets without drawing the attention of domestic revenue authorities. "Consequently, most large traffickers now utilize offshore bank secrecy havens as part of a more sophisti-

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[77] *See* George Penintaex, *Drugs: A $500 Billion Affair*, Inter Press Service, Apr. 4, 1990.

[78] *World Politics and Current Affairs: Drugs*, ECONOMIST, Sept. 2, 1989, at 21, 21 (based on estimates of production, transportation, and distribution costs compared to street value).

[79] *Cleaning Up Dirty Laundering*, ECONOMIST, Aug. 20, 1988, at 63, 63.

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cated laundering scheme capable of overcoming the obstacles inherent in the domestic laundering of enormous sums of 'narcodollars.' "[80]

The existence of offshore banks[81] in tax and secrecy havens and the reluctance of those countries to breach the confidentiality on which their financial sectors depend to attract deposits, have allowed drug traffickers to develop complex international money laundering networks. For drug traffickers seeking to launder money, financial secrecy is paramount in avoiding scrutiny by law enforcement and tax authorities.[82] Financial secrecy may also be desirable for personal, legitimate business, fiscal, and political reasons.[83]

The legal prototype for a secrecy haven was created in Switzerland during the 1930s.[84] Switzerland had a long tradition of privacy that was enshrined in the Swiss Constitution and the Civil Code. Switzerland responded to the world financial crisis of the 1930s and Nazi investigations into Jewish accounts in Switzerland by enacting the Banking Law

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[80] Jeffrey I. Horowitz, Comment, *Piercing Offshore Bank Secrecy Laws Used to Launder Illegal Narcotics Profits: The Cayman Islands Example*, 20 TEX. INT'L L.J. 133, 137 (1985).

[81] "[A]n offshore bank is a corporation organized and licensed under the banking laws of a foreign jurisdiction which is conducive to conducting international financial transactions with minimal tax, banking, and securities regulations." *Crime and Secrecy: The Use of Offshore Banks and Companies: Hearings Before the Permanent Subcomm. on Investigations of the Senate Comm. on Governmental Affairs*, 98th Cong., 1st Sess. 181 (1983) (statement of Jerome Schneider, President, W.F.I. Corp.) [hereinafter *Crime and Secrecy Hearings*].

[82] The need for financial secrecy is, however, by no means a new desire. In 1593, the first written reference to banking secrecy was made in the statutes of Italy's Banco Ambrosiano. "You are not to give information to other people, except to the (depositor), his [or her] attorneys and heirs, under penalty of losing office or greater sanction . . . ." *quoted in European Banking Secrecy and Disclosure Requirements: the Record*, FINANCIAL TIMES, Mar. 29, 1990, at 38.

[83] *See generally*, INGO WALTER, THE SECRET MONEY MARKET: INSIDE THE DARK WORLD OF TAX EVASION, FINANCIAL FRAUD, INSIDER TRADING, MONEY LAUNDERING, AND CAPITAL FLIGHT (1990).

[84] Andrea M. Grilli, *Preventing Billions From Being Washed Offshore: A Growing Approach To Stopping International Drug Trafficking*, 14 SYRACUSE J. INT'L L. & COM. 65, 68 (1987).

of 1934, which created tough criminal penalties for violators of disclosure prohibitions.[85]

Today, nearly forty countries in all parts of the world are considered secrecy and tax havens, including Switzerland, Austria, Monaco, Hong Kong, the Cayman Islands, Uruguay, Gibraltar, and the Bahamas.[86] Also, sitting in the center of the EEC, is Luxembourg, one of the three largest money havens in the world, with roughly $160 billion in foreign deposits in 120-odd banks.[87] Ironically, the number and

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[85] *See id.*; WALTER, *supra* note 83, at 190-91 (Following a revision of the code in 1982, article 47 of the Swiss Banking Law states:

> 1. Whoever divulges a secret entrusted to him in his capacity as officer, employee, mandatory, liquidator or commissioner of a bank, as a representative of the Banking Commission, officer or employee of a recognized auditing company, or whoever tries to induce others to violate professional secrecy, shall be punished by a prison term not to exceed six months or by a fine not exceeding 50,000 francs.
>
> 2. If the act has been committed by negligence, the penalty shall be a fine not exceeding 30,000 francs.
>
> 3. The violation of professional secrecy remains punishable even after termination of the official or employment relationship or the exercise of the profession.
>
> 4. Federal and cantonal regulation concerning the obligation to testify and to furnish information to a government authority shall remain reserved.).

[86] WALTER, *supra* note 83, at 187.

[87] *See* WALTER, *supra* note 83, at 222-23; Edwin A. Finn, *Luxembourg: Color it Green*, FORBES, Apr. 20, 1987, at 42, 42 (The Cayman Islands is acknowledged to be the largest haven with over $200 billion in deposits. Switzerland and Luxembourg are thought to be the second and third largest containing roughly equal deposits.).

The rise of Luxembourg as a money haven has coincided with the loosening of Switzerland's secrecy practices in the face of pressure from the United States. *See* Finn, *supra*, at 42-44. In 1986 alone, foreign deposits jumped 40% in Luxembourg. "At a time when most governments are enacting laws to erode banking and business confidentiality, Luxembourg has enacted new provisions forbidding its banks to disclose information to local and foreign . . . authorities." Zagaris & Bornheim, *supra* note 22, at 121. In both 1981 and 1984, the Luxembourg parliament passed new confidentiality statutes that, among other things, created mandatory jail sentences for anyone convicted of making unauthorized disclosures of financial information. In order to breach bank secrecy in Luxembourg an order from a Luxembourg court is required.Foreign authorities, however, are blocked from even seeking such an order "unless a depositor has been charged at home with an offense that is also a crime in Luxembourg and,

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sophistication of tax and secrecy havens that support much of international money laundering can be traced in part to the same changes in United States tax law that produced the growth of Euromarket financing.[88]

> Beginning in the 1960s, domestic [United States] corporations established offshore finance subsidiaries to avoid the effects of several changes in the United States income tax laws that made raising capital in foreign markets less advantageous. The boom in offshore Euromarket financing in turn resulted in the tremendous growth of offshore banking.[89]

With the establishment of a large network of banks in the tax and secrecy countries to handle the legitimate business from the Euromarkets, it did not take drug traffickers long to turn to the havens for their illegal needs.

Although the veil of secrecy over the havens' financial practices has prevented the development of much concrete information concerning the nature or extent of these schemes, the basic money laundering patterns are well-documented.

Drug profits initially come in the form of millions of small denomination bills collected from street sales.[90] The traffickers' first objective is to consolidate and reduce the volume of these funds so that they can be transported more easily.[91] The basic technique for this initial stage of launder-

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moreover, relates to the account in question." Finn, *supra*, at 44.

[88] *See* notes 57-61 and accompanying text.

[89] Horowitz, *supra* note 80, at 135.

[90] *See* Steven Wisotsky, *Exposing the War on Cocaine: The Futility and Destructiveness of Prohibition*, 1983 WIS. L. REV. 1305, 1332 (Wisotsky has calculated that in 1981 "a theoretical maximum of 360 million transactions" occurred on American streets.).

[91] Wisotsky explains:

> Importers and major dealers ... must confront the problem of processing a volume of cash so enormous that it must be weighed instead of counted, or counted with the aid of high-speed machines. In fact, one informant claims that 'getting rid of the money has become of the hardest part of the dope business.'

Id. at 1333 (citation omitted).

The advantage of consolidating the small bills received in street transactions into larger denominations can be seen by comparing the value of a given weight of bills: one pound of $20 bills equals $9,080, one pound of $100 bills equals $45,400; 100 pounds of $20 bills equals $908,000, 100 pounds of $100 bills equals $4,540,000. *See Crime and Secrecy Hearings*,

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ing is known colloquially as "smurfing." The "smurf"[92] changes the small denomination bills into large denomination bills, cashier's checks, or money orders by repetitively visiting bank after bank with amounts insufficient to arouse suspicion.[93] Cashier's checks and money orders are especially useful because, unlike two-party checks, "they are guaranteed and require no underlying bank account," and, unlike certified checks, "no payor need be identified."[94]

Once the trafficker has transformed the currency collected from street sales into a manageable form, the trafficker has two options for moving the money out of the country in which the drug sales were made. A courier may be hired to physically transport the funds to a money haven jurisdiction for deposit. Alternatively, the funds can be deposited in an account—which was opened using forged identity documents or in the name of a shell corporation—at a cooperative domestic bank. The funds can then be wire transferred to another shell corporation's account at a bank in the money haven.[95]

With the money safely deposited in a money haven bank, the trafficker can freely move the funds into legitimate investments anywhere in the world. The trafficker is also free to move offshore funds into the country of the trafficker's choice by making "loans" from the shell corporation's account at the money haven bank to a legitimate front company, another shell corporation, or an individual.[96]

Regardless of the method used,[97] money laundering has

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supra note 81, at 312.

[92] A smurf is a drug money courier, named after the small blue cartoon character of that name. *See* Sarah N. Welling, *Smurfs, Money Laundering, and the Federal Criminal Law: The Crime of Structuring Transactions*, 41 FLA. L. REV. 287, 288 (1989); Josephine Carr & Christina Morton, *How to Recognise a Money Launderer*, 8 INT'L FIN. L. REV., Aug. 1989, at 10, 12.

[93] *RICO Reform: Money Laundering - A Legal Analysis: Hearings Before the Subcomm. on Criminal Justice of the House Comm. on the Judiciary*, 100th Cong., 1st and 2nd Sess. 468 (1988) [hereinafter *RICO Reform Hearings*]; Welling, *supra* note 92, at 291 (Other popular forms for the smurfs to change cash into are postal money orders, gold, and stamps.).

[94] Welling, *supra* note 92, at 291 n.19.

[95] *See* Horowitz, *supra* note 80, at 139.

[96] *See id.* at 140.

[97] *Drug Money Laundering: Hearing Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 99th Cong., 1st Sess. 20 (1985)

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a number of detrimental effects. In particular, "laundering is harmful because it allows the underlying criminal activity to thrive . . . Without laundering, the risk/reward ratio for the underlying crime is unattractive . . . Efficient laundering renders the underlying crime lucrative, and therefore perpetuates it."[98] Moreover,

> Money laundering . . . is an extremely lucrative criminal enterprise in its own right . . . [I]nvestigations ha[ve] uncovered members of an emerging criminal class. They are professional money launderers who aid and abet other criminals through financial activities. These individuals do not fit the stereotype of an underworld criminal. They are accountants, attorneys, money brokers, and members of other legitimate professions. They need not become involved with the underlying criminal activity except to conceal and transfer the proceeds that result from it. They are drawn to their illicit activity for the same reason that drug trafficking attracts new criminals to replace those who are convicted and imprisoned; and that reason is simply greed. Money laundering, for them, is an easy route to an almost limitless wealth.[99]

The facilitation of criminal profit and the creation of a new category of criminal have combined with the loss of tax revenue from the money in the underground economy and the fear of widespread corruption of the world's financial system to spur the Council of the European Communities to approve a directive on prevention of the use of the financial system for the purpose of money laundering.[100]

[hereinafter *Drug Money Laundering Hearing*] (prepared statement of John M. Walker, Jr., Assistant Secretary (Enforcement and Operations), U.S. Department of the Treasury) ("There are seemingly infinite ways for criminals to accomplish [money laundering]."). For examples of money laundering schemes that have been uncovered *see RICO Reform Hearings*, *supra* note 93, at 466-68; WALTER, *supra* note 83, at 171-181.

[98] Welling, *supra* note 92, at 291.

[99] *Drug Money Laundering Hearing*, *supra* note 97, at 20-21 (statement of John M. Walker, Jr., Assistant Secretary (Enforcement and Operations), U.S. Department of the Treasury).

[100] Money Laundering Directive, *supra* note 23.

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4.2. Directive on Prevention of the Use of the Financial System for the Purpose of Money Laundering

The rationale behind the Money Laundering Directive is clear. The Explanatory Memorandum, which accompanied the Money Laundering Directive as it was originally proposed,[101] notes that "[t]he Community, which is responsible for adopting the necessary measures to ensure the soundness and stability of the European financial system, cannot be indifferent to the involvement of credit and financial institutions in money laundering."[102] The fear of financial regulators is that "when credit and financial institutions are used to launder proceeds from criminal activities . . . the soundness and stability of the [particular] institution concerned and confidence in the financial system as a whole could be seriously jeopardized."[103] As the preamble of the Money Laundering Directive acknowledges, "money laundering is usually carried out in an international context so that the criminal origin of the funds can be better disguised [therefore] measures exclusively adopted at a national level, without taking account of international coordination and cooperation, would have very limited effects."[104] Moreover, ad hoc domestic efforts to stop money laundering could slow or block the integration of the European financial system.[105]

[101] Proposal for a Council Directive on Prevention of Use of the Financial System for the Purpose of Money Laundering, 90/C 1990 O.J. (C 106) 6.

[102] Explanatory Memorandum on the Proposal for a Council Directive on prevention of the financial system for the purpose of money laundering, 1990 O.J. COM(90) 106 Final, at II, point 2 [hereinafter Explanatory Memorandum].

[103] Money Laundering Directive, *supra* note 23, pmbl. at 77.

[104] *Id.* at 78.

[105] For example:

> [L]ack of Community action against money laundering could lead Member States, for the purpose of protecting their financial systems, to adopt measures which could be inconsistent with the completion of the single market . . . [I]n order to facilitate their criminal activities, launderers could try to take advantage of the freedom of capital movement and freedom to supply financial services which the integrated financial area involves, if certain coordinating measures are not adopted at Community level.

Id. at 77.

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After defining money laundering[106] and the type of financial services firms covered,[107] the directive imposes significant new duties on Member States and the FSI.[108] The rest of this section provides a brief outline and commentary on those provisions of the Money Laundering Directive that create these duties.

Article 2 requires that the Member States "prohibit" money laundering as defined in the directive.[109] As of June 1990, France, Italy, Luxembourg, and the United Kingdom had already passed laws which criminalized money laundering; Belgium and Germany were considering similar legislation; Spain and the Netherlands had not adopted similar laws.[110]

Article 3 imposes significant specific duties on FSI firms in the form of so-called "know-your-customer" rules. Subsection 1, mandates that FSI firms "require identification of their customers by means of supporting evidence" prior to entering

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[106] Money laundering is defined in Article 1 of the directive as the following conduct when committed intentionally:

- the conversion or transfer of property, knowing that such property is derived from criminal activity or from an act of participation in such activity, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such activity to evade the legal consequences of his action,

- the concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing that such property is derived from criminal activity or from an act of participation in such activity,

- the acquisition, possession, or use of property, knowing, at the time of receipt, that such property was derived from criminal activity or from an act of participation in such activity,

- participation in, association to commit, attempts to commit and aiding, abetting, facilitating and counselling the commission of any of the actions mentioned in the foregoing paragraphs.

Id. at 79.

[107] For definition see footnotes 46-49 and accompanying text.

[108] According to Article 16, Member States are to have brought "into force the laws, regulations and administrative decisions necessary to comply with this Directive" by 1 January 1993. Money Laundering Directive, *supra* note 23 at 81.

[109] *Id.* at 79.

[110] Thomas Crocker, *Bankers, Police Yourselves*, 9 INT'L FIN. L. REV., June 1990, at 10, 10.

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into business relations with that customer.[111] Subsection 2 extends the identification requirement to all transactions, or series of transactions that appear linked, involving ECU 15,000 or more.[112] Subsection 6 effectively extends subsection 2 by imposing a duty on FSI firms to pursue identification of customers "even where the amount of the transaction is *lower* than the threshold laid down, wherever there is suspicion of money laundering."[113]

Such legislation forces FSI firms to scrutinize *every* transaction they engage in to determine if there is even the mere "suspicion" of money laundering. In order to identify a suspicion a financial institution will often have to question a client, even if that client appears to be legitimate. Such questioning, however, is likely to cause a client, whether honest or not, to find a different firm with which to conduct business.[114] While financial firms obviously find such a result unacceptable, those who support this requirement contend that "[o]nly if every [FSI firm] is under a duty to so question every client is the 'embarrassing' problem removed."[115]

In instances where the FSI firm is unsure if a customer is acting on its own behalf, and even in cases where there is no suspicion of money laundering, subsection 5 requires that the institutions "take *reasonable measures* to obtain information as to the real identity of the persons on whose behalf those customers are acting [i.e., the beneficial owner]."[116]

"Know-your-customer" rules have been heavily criticized as being economically unworkable. The Money Laundering Directive will force FSI firms to scrutinize every transaction they engage in both to eliminate the suspicion of money laundering (and consequently, the duty to perform identification procedures on a customer) and to ensure that a customer

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[111] Money Laundering Directive, *supra* note 23, art. 3, subsec. 1, at 79.

[112] *Id.*, art. 3, subsec. 2, at 80. ECU 15,000 is worth approximately US$ 18,000. This reporting requirement is similar to the rules for American banks.

[113] Money Laundering Directive, art. 3, subsec. 6, at 80. (emphasis supplied).

[114] *See* Carr, *supra* note 92, at 13.

[115] *Id.*

[116] Money Laundering Directive, *supra* note 23, art. 3, subsec. 5, at 80. (emphasis supplied).

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is acting for itself and not someone else, even if their motives are completely legitimate. Prior to the Directive's approval, a lawyer noted that it

> would certainly [create] an upward pressure on fees. Someone would have to pay for the time spent on investigating the client and recording the fact that all the proper checks had been made. Either there would be a significant decrease in fee income . . . or an increased cost to the client.[117]

As the globalization and liberalization of currency transactions turns financial services into more of a commodity business, either outcome would adversely effect EEC FSI firms competing for deposits from around the world.

Article 4 further ensures that EEC FSI firms's costs will rise by requiring them to keep evidence of customer identification for at least five years after the relationship with a customer has ended and to keep transaction records for at least five years following execution of a transaction.

Article 5 places a duty on Member States to ensure that FSI firms "examine with special attention any transaction which they regard as particularly likely, by its nature, to be related to money laundering."[118] As with Article 3, this requirement means that FSI firms will have to scrutinize virtually every transaction they carry out, because Article 5 places the burden, and thus the liability, of identifying money laundering transactions on the firms.

Article 6 creates another affirmative duty for FSI institutions and explicitly imposes it on their directors and employees as well. Article 6 requires firms to "cooperate fully with the authorities responsible for combating money laundering by informing those authorities, *on their own initiative*, of any fact which might be an indication of money laundering."[119] This requirement places FSI firms in danger of being penalized for failing to inform when the authorities deem they should have. Article 6 also dictates that financial institutions are to turn over to the authorities "all necessary information." The lack

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[117] An unidentified lawyer *quoted in* Christina Morton, *Will the Net Close in on Lawyers?*, 8 INT'L FIN. L. REV., Aug. 1989, at 11, 11.

[118] Money Laundering Directive, *supra* note 23, art. 5, at 80.

[119] *Id.*, art. 6, at 80. (emphasis supplied).

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of a specific definition of necessary information appears to give the law enforcement authorities unprecedented power to seize firms' records.

Article 7 attacks the ability of FSI firms to govern their own affairs by requiring them to "refrain from carrying out transactions which they know or suspect to be related to money laundering until they have apprised the authorities. . . . Those authorities may . . . give instructions not to execute the operation."[120] FSI firms are thus required to relinquish their operational authority and submit to the decision-making of state authorities. Article 7's second sentence appears to be a potential loophole which may minimize the impact of that article's first sentence; the second sentence states, "Where . . . a transaction is suspected of giving rise to money laundering and where to refrain [from carrying out such transaction] is impossible or is likely to frustrate efforts to pursue the beneficiaries of a suspected money-laundering operation, the institutions concerned shall apprise the authorities immediately afterwards."[121] Even if a firm can avoid submitting its initial decision to state authorities based on this second clause, however, the notification requirement will open the firm to second-guessing and possible censure for failing to inform authorities prior to performing a transaction.

Article 9 absolves institutions, directors and, employees from any civil or criminal liability for disclosing in good faith the information required in Articles 6 and 7. Accordingly, this article states that the delivery of such information to the authorities "shall not constitute a breach of any restriction on disclosure of information imposed by contract or by any legislative, regulatory or administrative provision."[122]

Article 9 thus seeks to attack the secrecy barriers that countries (e.g., Luxembourg) have erected and which have helped expand the FSI in those countries. By leveling the secrecy advantage Article 9 decreases the likelihood of large outflows of capital from countries with strict reporting requirements to countries with strict secrecy regimes. However, the dismantling of client account protections also

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[120] *Id.*, art. 7, at 80.
[121] *Id.*
[122] *Id.*, art. 9, at 81.

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exposes legitimate accounts to the danger of a mandatory release of valuable confidential information. This article subordinates depositors' privacy rights to the right of state authorities to step in and scrutinize any transaction merely by alleging that such transaction is "suspicious." The FSI has ended up caught in the middle—affirmatively required to act as a quasi-state enforcement agency and to provide information to the authorities, but answerable in the commercial marketplace to disgruntled depositors whose financial privacy is being assailed.

Article 11's first subsection states that "Member States shall ensure that credit and financial institutions establish adequate procedures of internal control and communication in order to forestall and prevent operations related with money laundering."[123] Subsection 2 mandates that firms make their employees aware of the Money Laundering Directive's provisions by holding "special training programmes" for "relevant employees" in order "to help them recognize operations which may be related to money laundering as well as to instruct them as to how to proceed in such cases."[124] FSI firms are thus forced both to give up a significant amount of control over their internal governance and to pay for this loss of control themselves through the required sponsorship of special programs.

4.3. Effect of the Money Laundering Directive on Competition Within the FSI

Financial services firms have traditionally had two main duties: first, to correctly carry out client orders while acting in the best interests of each client; second, to manage the bank profitably while avoiding risks that would threaten the institution's solvency.[125] The firms' duty of confidentiality in relation to its clients has generally circumscribed these traditional duties.[126]

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[123] *Id.*, art. 11, subsec. 1, at 81.

[124] *Id.*, art. 11, subsec. 2, at 81.

[125] *See* Alain Hirsch, *"Dirty Money" and Swiss Banking Regulations*, 8 J. COMP. BUS. & CAP. MKT. L. 373, 373 (1986).

[126] For example,

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Despite the asserted rationale that coordinated action is necessary to regulate money laundering effectively without diminishing the competitive advantage of the common market, the imposition of the Money Laundering Directive's new duties brings into question the ability of EEC FSI firms to meet their traditional duties while profiting fully from the competitive advantage created by free capital movement.

The interplay between the regulatory effect of the Money Laundering Directive and the deregulatory effect of the free movement of capital will create competitive pressures that will have notable impact on firms' set of potential responses to the new legal requirements imposed by the Money Laundering Directive.[127] The laws themselves will not solely determine the FSI's behavior; rather, the competitive forces unleashed by the change in legal structure will themselves largely determine how firms choose to react to the new legal environment. In all likelihood, the competitive forces produced by the on-going liberalization of capital movements will work against the FSI's desire to comply with the new duties required by the Money Laundering Directive. This friction will affect the EEC FSI's competitive posture both within the EEC and in relation to the rest of the world.

The free movement of capital is one manifestation of the EEC's recent adoption of a "remove the barriers first and let national systems compete for survival afterwards"[128] approach to legislation. In principle, such a "competitive lawmaking" scheme will produce some Member States that offer more advantageous business laws than other Member States. The free movement of capital will eventually allow

> [i]n the UK the case of *Tournier v. National Provincial and Union Bank of England* (1924) established the legal basis of the duty of confidentiality. The case held that it is a contractual duty between bank and customer not to disclose information unlawfully to third parties. But the case also established four exceptions: where disclosure is under compulsion of law; where there is a duty to the public to disclose; where the interest of the bank require [sic] disclosure; where disclosure is made with the express consent of the customer.

Carr, *supra* note 92, at 12.

[127] *Cf.*, Gregory J. Lyons, *Taking Money Launderers to the Cleaners: A Problem Solving Analysis of Current Legislation*, 9 ANN. REV. BANKING L. 635, 644 (1990).

[128] *Europe's Capital Achievement*, ECONOMIST, June 18, 1988, 14, 14.

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businesses to migrate to those Member States with legal systems that best serve their needs.

The danger in competitive lawmaking is twofold. On the one hand, Member States may feel compelled to follow a lowest common denominator approach to legislation, ensuring that the level of regulation imposed in the least regulated Member State will become the norm throughout the EEC. On the other hand, a group of Member States could band together to force the imposition of EEC-wide regulations aimed at diminishing or destroying a single Member State's competitive legal advantage. In this case, the EEC would be defeating the free competition goal that the economic union is supposed to be based on.

In the case of the FSI and money laundering, this lawmaking dilemma is posed most acutely by Luxembourg. While most governments have passed laws to erode banking and business confidentiality, Luxembourg has established new laws forbidding its banks to issue information to local or foreign tax authorities.[129] Under current EEC policy, Member States will be required to follow common procedures in the collection and exchange of currency transaction information, unless a Member State already has conflicting national laws or formal administrative regulations.[130] Luxembourg's move to create conflicting national legislation before the imposition of common standards is a clear signal that they will not give up the confidentiality on which their financial sector has come to depend without a fight.[131]

Luxembourg's opposition to the type of duties that the Money Laundering Directive imposes has two possible outcomes. First, if Luxembourg wishes to remain a secrecy haven in spite of the directive and thus refuses to bring its financial disclosure requirements into line with the rest of the EEC, either by delaying the passage of the necessary legislation to enact the Money Laundering Directive or by only

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[129] Zagaris & Bornheim, *supra* note 22, at 121.

[130] *Id.*

[131] Luxembourg has passed laws criminalizing money laundering and has given indications that it will cooperate with criminal investigations. *Id.* These measures, however, do not evince any enthusiasm for the affirmative duty to specially scrutinize customers and transactions imposed by the Money Laundering Directive. *Cf.*, William Park, *Legal Policy Conflicts in International Banking*, 50 OHIO ST. L.J. 1067, 1095 (1989).

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loosely enforcing its provisions, the free movement of capital will combine with the attraction of greater financial confidentiality to drain capital from the rest of the EEC into Luxembourg. This capital outflow may severely hurt the FSI of the other 11 Member States, who would have to contemplate individual legislative responses to the competitive advantage created by Luxembourg's secrecy laws. Moreover, the survival of Luxembourg's confidentiality laws would leave money launderers a secrecy haven within the EEC that would allow them, by moving their money into Luxembourgian accounts, to spread their laundered funds throughout the EEC free from border controls, reporting requirements, or other traditional law enforcement deterrents. The specter this scenario raises is that the huge profits generated by the drug business once ensconced in secret Luxembourg accounts could be used by the traffickers to gain control of significant businesses and real estate throughout Europe.

The fear of Europe awash in drug money points to the second possibility created by Luxembourg's potential unwillingness to compromise its banking secrecy through submitting to the duties required by the Money Laundering Directive. If the Luxembourg government embraces the Money Laundering Directive, the FSI in Luxembourg, recognizing the continued importance of its tradition of confidentiality in competing with other money markets, may act in tacit unison to ignore or impede the newly imposed duties.[132] The huge flow of currency in and out of Luxembourg that is likely to arise with the advent of free capital movement will limit the effectiveness of law enforcement officials in policing currency transactions.[133] This scenario would allow the FSI in Luxembourg to reap the combined competitive advantage of financial secrecy and free capital movement, while making it difficult for other Member

[132] The basic question raised here is whether members of the FSI, although private entities, should be forced to act as quasi-public institutions in reporting on potential money laundering activity. *See* Hirsch, *supra* note 125, at 373.

[133] In addition to its secrecy laws, Luxembourg's tax laws (e.g., no withholding tax on interest payments to investors) ensure that the country will be a powerful magnet for attracting funds to its FSI even if its confidentiality rules are officially relaxed. *See 1992; The Barriers Within*, *supra* note 11, at 15.

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States to target the Luxembourg government as a scapegoat for failing to support the Money Laundering Directive.

In order to remain competitive, the FSI in other Member States would have to respond to the practices developed in Luxembourg. Competitive pressure could thus thwart the policies behind the Money Laundering Directive by making it economically infeasible for firms to comply with the strict reporting requirements. Law enforcement bodies would then be left to police tightly not only the traffickers, but the FSI itself to ensure that the Money Laundering Directive's requirements were being met. This new burden would further strain already taxed law enforcement capabilities.

The situations outlined above indicate the difficulty of reconciling the free movement of capital and the control of money laundering within the competitive lawmaking model adopted by the EEC. On a world-wide scale these goals are equally difficult to tally with each other and with the realities of an increasingly competitive financial market place.

The affirmative duty imposed by the Money Laundering Directive to report certain types of transactions creates a fear in the FSI of repercussions from customers who discover their financial services institution has revealed their account information to the government.[134] The questions a firm must ask to identify the beneficial owner of an account may similarly create misunderstandings with a client, especially as these questions would normally not be asked by firms in other countries. Clients may resent the mistrust implied by such questions, "a mistrust which would be regarded as an unsuitable basis of relations between a [firm] and its clients."[135] This problem is likely to be particularly acute when a FSI firm is dealing with a foreign customer who will be particularly sensitive to perceived slights based on nationality. Either the revealing of account information or the asking of too many sensitive questions is likely to drive customers to seek financial services elsewhere, probably in countries which are more accommodating than those in the EEC.

The monitoring duties placed on the FSI will become increasingly difficult to meet as the speed of international

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[134] *See* Lyons, *supra* note 127, at 649.

[135] Hirsch, *supra* note 125, at 374.

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business picks up creating larger numbers of capital flows in more complex and sophisticated transactions involving more businesses. The competitive advantage that the free movement of capital has created for the EEC FSI will erode as firms' ability to accommodate their customers in a fast and efficient manner decreases. This decline will occur in direct proportion to the complexity and subjectivity of the reporting requirements imposed by the Money Laundering Directive.[136]

The bottom line of the FSI will further be hurt by the direct costs incurred as the result of setting up reporting mechanisms, training employees, and insuring against liability for failing to recognize an illegal transaction later identified by law enforcement authorities. While these direct costs will particularly hurt smaller and more marginal firms, they also symbolize the danger of destroying the level playing field needed for the free movement of capital. As with any regulatory scheme, firms will choose to follow the duties the Money Laundering Directive has imposed with varying degrees of attention. Unless enforcement of these duties is swift, uniform, and precise, less diligent firms will gain a competitive advantage. Those firms receiving particular scrutiny will thus be at a disadvantage as compared to other EEC and non-EEC firms.

Perhaps the EEC FSI's biggest fear is that instead of reaping a financial windfall based on the Capital Movements Directive's competitive advantages, the Money Laundering Directive's competitive disadvantages will bolster presently outlying financial centers by pulling capital away from the major European financial centers. If the major financial centers see too much capital flowing to outlying centers, how long they will actively comply with reporting requirements that are detrimental to their competitive position in the world market is unclear.[137]

[136] *Cf.*, Lyons, *supra* note 127, at 650.

[137] *Cleaning Up Dirty Laundering*, *supra* note 79, at 63. (While the major financial centers clearly do not want to actively aid money laundering, they may well feel that the reporting requirements are an ineffective and unfair competitive disadvantage when "[r]affish financial centres such as Vanuatu, Uruguay, and Hongkong, are full of banks more interested in taking a deposit, any deposit, than in scanning the references of potential customers.")

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5. CONCLUSION

Competing goals of international finance law, each attractive when considered alone, often produce friction when implemented together. The free movement of capital, as embodied in the Capital Movements Directive, is accepted as a necessary legal construct if the EEC is to achieve its goal of an unfettered common market. Money laundering is a large and persistent problem that the Money Laundering Directive seeks to address by regulating financial services transactions. The friction these two directives are likely to create as they are enforced simultaneously is exemplified by the situation in Luxembourg. In that country many bankers believe banking secrecy is vital to the ability of the country's FSI to attract deposits, while law enforcement officials in the EEC see this secrecy primarily as an instrument facilitating money laundering.[138]

In balancing the effect these potentially competing directives have on the financial services industry in the European Economic Community, it is important to keep in mind that the fundamental goal of the economic union is to create a zone of free competition throughout Europe. The EEC must be wary that in approaching the goal of a common market it does not do away with the present restrictive maze of national regulation merely to erect in its place a new labyrinth of pan-European regulation.

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[138] *Cf.*, Park, *supra* note 131, at 1068.

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