The Evolution of Community Law on Financial Services

Prof. Dr. Norbert Reich
Universität Bremen
Bibliothekstr. 1, GW II
28359 Bremen

John Cecil van Aken
Rechtsreferendar

c/o Zentrum für Europäische Rechtspolitik
an der Universität Bremen
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Preface

This paper is the forerunner of a series of studies done under the auspices of the research project "Southern Extension of the EC and Financial Services", supported by Stiftung Volkswagenwerk under its research programme "Süderweiterung der EG". Researchers and practitioners from four countries, namely the United Kingdom, Germany, Spain and Greece participated in this project under the general supervision of the undersigned and in close cooperation with the Zentrum für Europäische Rechtspolitik an der Universität Bremen (ZERP - Centre for European Law and Policy, Bremen).

First plans on research cooperation were started in 1989 when the internal market programme of the Community was on its full way and the need to allow for differentiated instruments of harmonization played a great role; it found official recognition in Art. 8c of the Treaty of the European Economic Community as amended by the Single Act of 1987. Financial services seemed a good example to evaluate the two step integration concept: the Southern countries, especially Spain and Greece, showed more resistance to the Community policy at opening markets and therefore needed delays as well as safeguard clauses in the implementation of Community harmonization measures.

During the research work, the perspective however changed considerably. The concept of two step integration partly lost its significance because market opening could not be reached by 31st of December 1992 for all financial services, but only with respect to banking; insurance markets were to be opened and access liberalized only by 1st of July 1994.

On the other hand, the development of adequate instruments of consumer, depositor and policy-holder protection became more and more important in all Member States, not only in Southern
countries. Community law was particularly deficient in this respect and had established only very few instruments for this purpose, all using different legal techniques. The further research therefore concentrated on case studies to look at the elaboration of performance standards taking as a base a "high level of protection", per Art. 100a para 3 EEC Treaty. Due to the still divergent legal traditions of the countries investigated and the near to complete absence of harmonization of banking and insurance contract law, the research project concentrated on two variables which are particularly important both for a (cross-border) marketing of financial services and for a consumer protection point of view, namely transparency and complaint handling. The participants always aimed at looking into the actual working of these principles by using the method of qualitative case studies. These had to be undertaken with divergent subject matters because of different Member State concerns.

The study consists of the following reports whose results had been discussed jointly but whose methods and results are within the exclusive responsibility of the participating groups of researchers:

- N. Reich and J.C. van Aken, Bremen University: Introduction to Community law on financial services with special regard to banking.
- G. Woodroffe, Ph. Rawlings, Brunel University and Chr. Willet, Warwick Univ., UK: Financial services in the UK.
- P. Bueso-Guillén and J. Santos, Univ. of Zaragoza: Case study on the protection of credit and payment card holders in Spain (in Spanish with an English summary).
- E. Alexandridou, Chr. Mastrocostas, M. Marinos and G. Triantaphyllakis, Komotini University of Thrace, Greece: Greek consumer protection law and market integration in financial services (in German and French with an English summary).
- E. Castelló, Verbraucherzentrale Hamburg: Complaint handling systems in Germany for financial services, with
special regard to cross-border services (in German with an English summary).

- W. Scholl, Verbraucherzentrale Nordrhein-Westfalen, Düsseldorf: Transparency rules on insurance products (in German with English summary)

- M. A. López-Sanchez and M. Obrero, Universities of Burgos and Zaragoza: Spanish law on financial services with special regard to complaint handling and consumer arbitration (in Spanish with English summary)

Each will be published separately as a ZERP discussion paper. A final report will be prepared by the undersigned hoping to evaluate the findings of the research project.

Bremen, February 1994 Norbert Reich
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THE EVOLUTION OF COMMUNITY LAW ON FINANCIAL SERVICES AND CONSUMER PROTECTION

I. General remarks

When, in past, one used to talk about consumer protection in contracts for services the ensuing presentation could be limited to an analysis of the various national laws, under the headings of public and private law. One would find that the solutions differed according to the economic, political and legal traditions of each country. For example, in the case of insurance contracts English law has always preferred liberal unregulated solutions while both German, Spanish and Greek law insist on mandatory control not only of financial solvency but also of the contracts offered to consumers.

Such a comparative approach is no longer sufficient to understand the law of services nowadays. The Community perspective becomes evermore important in an Internal Market which must also be completed in the realm of services, especially financial services. The countries comprised in the European Free Trade Area (EFTA) must also adapt to this economic and legal reality within Art. 36 of the Agreement on the European Economic Area (EEA)\(^2\), in which they are obliged to adopt the *acquis communautaire*.

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1 Earlier versions of this paper had been published in German, English, and French; this paper tries to cover the most recent developments in Community law and policy as of 1 Jan. 1994.

2 The agreement was signed in Oporto on 2 May 1992 and published by the Office for Official Publications of the EC in 1992, it entered into force on 1 Jan. 1994.
This viewpoint applies as much to administrative law as it does to private law. The regulation of contracts for services by national public authorities form the object of an increasingly stringent inquiry on the part of Community law, which allows us to presuppose a fundamental conflict with the opening of the market for services. In this vein, regulations forming part of national public law become more or less direct and intensive restrictions to the free movement of services which was one of the fundamental objects of the Treaty of Rome since the amendments contained in the Single Act (Art 8 A, para 2), now Art. 7 B as amended by the Maastricht Treaty on European Union. This conflict has been hotly debated in regard to insurance contracts. Here, Community law follows the method of *opening-up of markets by negative integration*\(^3\): the freedoms contained in the Treaty of Rome override national rules having a discriminatory or unreasonably restrictive effect on the free movement of services. Primary and secondary Community law have as their goal the elimination of all impediments, both direct and indirect, to this basic freedom guaranteed by Arts. 59 et seq.

However, there is another trend in Community law. Rules are being enacted to establish minimum levels of consumer protection. One of the means for so doing is the establishment of common rules in the field of private international law. This is the method followed in the Rome Convention (which entered into force on the first of April 1991)\(^4\), in particular, in Art. 5 thereof which

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\(^3\) Reich, Europäisches Verbraucherschutzrecht - Binnenmarkt und Verbraucherinteresse, 1993, No. 10; Reich/Leahy, Internal Market and Diffuse Interests, 1990, No.7.

\(^4\) It is now valid for all Member States including Spain and Portugal which ratified the Convention, cf. OJ L 113/13 of 30.4.92.
institutes a special regime for contracts entered into by consumers\textsuperscript{5}, as to the Directives 88/357/EEC and 90/619/EEC\textsuperscript{6} dealing with direct insurance.

The other means consists in establishing harmonised rules with regard to the permissible contents of contracts for services. It is here that Community legislation is found particularly lacking. Community legislation has confined itself, until now, to adopting some minimum rules in relation to consumer credit in Directive 87/102/EEC of 22.12.86\textsuperscript{7}. The task of harmonising insurance contracts has run aground. For other financial services there exist only recommendations as instruments of soft law\textsuperscript{8}, e.g. Rec. 88/590/EEC for electronic\textsuperscript{9} means of payment and Rec. 90/109/EEC concerning transparency of applicable charges in cross-frontier banking operations\textsuperscript{10}. Investment services which anyway only affect a small proportion of consumers will not be dealt with here\textsuperscript{11}.

\textsuperscript{5} Official Journal of the European Communities (OJ), L266/1 of 9.10.1980, together with explanation contained in the Giuliano Report, OJ C 285/23 of 31.10.1980.

\textsuperscript{6} OJ L 172/1 of 4.7.88 and L 330/50 of 29.11.90 respectively.

\textsuperscript{7} OJ L 42/48 of 12.2.87.

\textsuperscript{8} Cf. Wellens and Borchardt, ELR 1989, pp. 267-321; The European Consumer Law Group has strongly criticised this approach, see JCP 1989 pp. 209-224.


\textsuperscript{10} OJ L 67/39 of 15.3.90.

These opening remarks outline the complex task of this paper which hopes to comment upon the changes wrought by Community law on consumer protection in contracts for financial services, namely in its double goal of opening national markets for services and guaranteeing effective minimum protection for consumers. Insurance contracts and electronic means of payment can be taken as examples of developments which have not as yet yielded clear solutions, but which are very important for the realisation of the goal of the Single Act, that is, the arrival by consumers in the Internal Market at a "high level of protection" (see Art 100a, para 3). This is however not sure because most Community legislation in the field of (financial) services is based on Art. 66, 57 (2), not Art. 100a, thereby not insisting on a high level of protection of the Commission's proposals. This is supported by the Maastricht Treaty, in force since 1 Nov. 1993, whereby the Union, according to Art. 3(s) EC-Treaty as amended, "contributes to the strengthening of consumer protection, which must attain a high level of protection", Art. 129a(1).

II. Community law's so-called "negative" impact on contracts for services

1. "Mobility" of services and free choice for consumers

This impact of Community law is the consequence of a very expansive application of the rules on the freedom of services to any state regulation which has a negative effect, either actual or potential, on the free supply of services in the Internal Market. These principles are not a result of the Single Act, but of the
innovative case law of the European Justice at Luxemburg on the object and application of Arts. 59 et seq. It is not here necessary to go into the debate on the application of Art. 59 to contracts for services. In doctrine and case-law we have arrived at an entirely analogous interpretation of the propositions relating to the right to perform services on the one hand, and the rules on the free movement of goods on the other. There are some exceptions for services marked by either a personal or a professional element, such as the services of lawyers, doctors, etc. The special problems to which public services or service monopolies give rise in relation to Community law will not be dealt with here.

With regard to services which can be "sold" across frontiers such as insurance services, and payment and credit cards, Community law protects and defends their "mobility". This fundamental right is guaranteed to the entrepreneur who has thus the right of access to all the Internal Market on equal conditions without there being any disproportionate or discriminatory restrictions. The consumer has for his or her part the right to choose freely where he or she wishes to avail of services. The freedom in the supply of services has thus two objects, if my interpretation of the new case law is correct: on the one hand, protection of the supplier and on the other, protection of the actual or potential consumer of services. Doctrine, until now, has not yet clearly recognised this second strand of the right freely to perform

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12 Recent case law, especially the Keck-case C-267/91, judgment of 24. Nov. 1993, shed some doubt on this proposition, but cannot be dismissed here.

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services, but it is present in the new case-law such as in the decisions of the cases of *Luisi*\(^{14}\) and *Cowan*\(^{15}\). This point was spelt out very clearly by Advocate General Lenz in his conclusions in the *Cowan* case. He underlined that Community law not only protects the right of the supplier of services freely to act in another Member State, as is explicitly stated in Art 60(3), but also the converse right of the recipient of services:

"Although most attention has been focused on the person providing services, that cannot mean that the recipient of services plays no role from a legal point of view. As a necessary party to the transaction he too is a potential beneficiary of the freedom to provide services under Community law."\(^{16}\)

In its judgment in the *GB-INNO-BM* of 7 March 1990\(^{17}\), the Court emphasised the consumerist element in the parallel rules permitting free movement of goods:

"Free movement of goods concern not only traders but also individuals. It requires, particularly in frontier areas, that consumers resident in one Member State may travel freely to the territory of another Member State to shop under the same conditions as the local population. That freedom for consumers is comprised if they are deprived of access to advertising ... (para.8)."

These principles can and must be applied to the Community rules on the free provisions of services.

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16 Ibid at p. 207, § 17.

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It is not here necessary to make a precise presentation of the elements of Community law in order to justify this point of view. Suffice it to underline that the services here discussed are obviously characterised by a remunerative\textsuperscript{18} and cross-border aspect which has always been the prior condition for the applicability of rules of Community law. It is therefore clear that Community law is always applicable to the services to which this article refers. This view was confirmed, as regards insurance contracts, by the European Court of Justice in a decision of 4 December 1986\textsuperscript{19}. As far as means of payment are concerned, this freedom is guaranteed by Art. 106, as well as by the liberalisation of capital markets contained in Directive 88/361/EEC\textsuperscript{20}. It must, however, be said that Directive 87/102/EEC on consumer credit has not in any way opened up national markets to cross-border consumer credit services.

This freedom has important legal consequences. The provider of services must be allowed a huge panoply of supplementary rights in order to realise his or her right of free access to the market, for example, the right to advertise, the right to move his or her activity from one country to another without being established in the host country, the right of access to public markets etc\textsuperscript{21}. The consumer has the right to full information on

\textsuperscript{18} This is not the case for public services such as national secondary education, cf. ECJ, 27 Sept 1988, [1988] ECR 5365, Case 263/86 - Humbel.

\textsuperscript{19} Case 205/84 Comm.v.FRG, [1986] ECR 3755.

\textsuperscript{20} OJ L 178/5 of 8.7.88; Mattera, loc. cit., pp. 551-8.

\textsuperscript{21} For details see Micklitz/Reich, Legal Aspects of European Space Activities, 1989, pp.56-60; ECJ decision of 5 Dec 1989 Case C-3/88 (1989) ECR 4035 (4059) - Comm v. Italy.
the nature of the services offered to him or her; restrictions in national law which limit access to truthful information, as for example German case-law enjoining non-misleading comparative advertising\textsuperscript{22}, cannot be justified in the face of Community law. The Commission proposal for a Directive on comparative advertising\textsuperscript{23} would expressly guarantee this right to non-misleading information in favour of the consumer.

2. \textit{Exceptions in the field of insurance}

This form of "negative integration" is in the interest of both suppliers and consumers. It has not, however, been attained in insurance markets by primary Community law. The European Justice, in a fundamental decision of 4 Dec. 1986, motivated by the desire to protect insurance policy-holders and insured persons, gave a very broad interpretation to rules on the applicability of the right of establishment. This decision which has been strongly criticised has, in effect, allowed the continuing partitioning of insurance markets\textsuperscript{24}. The Community, in its second Directive on direct insurance 88/357 of 22 June 1988\textsuperscript{25}, has opened up the

\textsuperscript{22} Reich/Ahrzoglu, EG-Binnenmarkt und Werberecht, 1990.

\textsuperscript{23} OJ C 180/1 of 11.7.1991; cf. Reich, SydLR 1992, 23 (38).

\textsuperscript{24} See the criticisms of Schlappa, Die Kontrolle von AVB im deutschen Versicherungsaufsichtsrecht und der freie Dienstleistungsverkehr im EG-Recht, 1987, p. 234 ff.; also Schwintowski, NJW 1987, 521; Berr/Grontel, RTDE 1987, 83; Steenbergen, CDE 1987, 542; Hodgin, CMLR 1987, 273; Roth, RabelZ (54) 1990, 63.

\textsuperscript{25} OJ L 172/1 of 4.7.88.
market, with some qualifications, for "commercial risks"\textsuperscript{26} in the case in which policy holders "do not require protection in the State in which the risk is situated" (Recital 12). For mass risks, the policy holder was still protected by the applicability of the law of the country in which the risk is situated. Applicability of law includes supervision by public authorities, which can thus entail a restriction of free circulation of services allowed to foreign insurers and hence a limitation on the free choice of consumers.

This partitioning of markets had survived in the original draft Second Directive on direct life assurance\textsuperscript{27}. The Commission wanted only to allow freedom of choice to those policy-holders who take "the initiative in seeking a commitment from the undertaking", Art. 13. This idea was to be confined to the two following cases:

- "where the initial contact between the policy holder and the undertaking, regardless of the means used, is made by the policy holder, or

- where the contract is concluded in the Member State in which the undertaking is established without there being any prior contact between the policy holder and the undertaking in the Member State in which the policy holder has his or her habitual residence."

Even after this proposal, the insurer could not use intermediaries to sell its insurance contracts in the policy holder's state, nor could it send out prospectuses or advertise commercially. Had these proposals been adopted by the Council, they would substantially have limited the freedom of services that

\textsuperscript{26} On this concept cf. Berr, RTDE 1988, 655 (661): "The fundamental innovation of the directive".

\textsuperscript{27} OJ C 38/7 15.2.89.
they purported to guarantee! They might even have been contrary to primary Community law on the direct effect of the right to provide services\(^2^8\). It is true that the passive consumer must be protected from the commercial promotion of life assurance contracts subject to a foreign jurisdiction and which are in danger of guaranteeing neither the profitability of his investment nor the protection of the assured risk. Given this goal the Commission proposal was excessive, as far as the active consumer is concerned.

In its amended proposal, the Commission had recognised the necessity of establishing common rules which facilitate transparency in contractual conditions for the consumer policyholder while at the same time opening up markets to insurers from all Member States\(^2^9\). It had accordingly modified its proposed Directive on life assurance\(^3^0\). These proposals were adopted by the Council in the Second Directive on direct life assurance (90/619/EEC)\(^3^1\). Art 13(1), para 2 allows for the conclusion of contracts through agents resident in the country of the policyholder, provided that the former has signed a declaration indicating that the insurer has undergone the controls of the country of origin and not in the policy-holder's state. The former proposal on the prohibition of advertising and of commercial activity of the insurer and his agents does not figure in the new text.


\(^2^9\) In this regard cf. Schlappa, aaO p 224; Finsinger, Versicherungsmärkte, 1984.

\(^3^0\) Com(90) 46 final of 1 March 1990, OJ C 72/1 of 22.3.90.

\(^3^1\) OJ L 330/50 of 29.11.90.
3. The new trend: "deregulation" of insurance markets

Then a more radical step was taken by the "third generation Directives" 92/49/EEG of 18 June 1992 non-life\textsuperscript{32} and 92/96/EEEG of 10 November 1992 life\textsuperscript{33} aiming at a fundamental deregulation of the insurance market by means of the mutual recognition of government authorization and systems of prudential control. The details of this complex legislation cannot here be analysed. It follows the model of the Second Banking Directive 89/646/EEC of 15.12.1989\textsuperscript{34} which will be analysed in detail by the paper of v. Aken in this volume. The distinctions between commercial and mass insurance respectively active and passive policy-holders have been abandoned. Insurers will have the unfettered choice of marketing their policies through the setting up of branches or by the free provision of services (Art. 32). The controls on professional activity will nonetheless take place in the State of origin. The powers of the host country are limited to safeguard clauses and cannot extend to prior controls on the insurance policies (Arts. 39 & 40), as is currently the situation in Germany.

The most radical deregulation involves the abolition of any ex-ante control of general and special insurance policies, rates and forms (Art. 29). National authorities may only carry out a posteriori controls through a "non-systematic" notification of these conditions, with the exception of compulsory insurance and health insurance taking the place of social security (Arts. 30 & 54). As

\textsuperscript{32} OJ L 228/1 of 11.8.92.

\textsuperscript{33} OJ L 360/1 of 9.12.92.

\textsuperscript{34} OJ L 386/1 of 30.12.89.
far as life assurance is concerned, the home control authority may require notification of the data sheets for technical reserves, Art. 29 (2).


III. Restrictions still Justified under Community Law

Community law is very strict towards any restrictions on cross-border movements of services. This stringent approach applies also to restrictions on the freedom of services which are more or less indirect and potential. This does not mean that restrictions can no longer be justified by reason of public interest of Member States, e.g. in the case of protection of consumer interests.

It is well known that the Court has developed the so-called "Cassis de Dijon"35 doctrine which permits restrictions on the free movement of goods for reasons not found in Art. 36 EEC Treaty. These derive from the "mandatory requirements" of the Member States. As examples one can cite defence of consumer interests, the protection of the environment and the ensurance of fairness in commercial transactions. These same principles have been applied ceteris paribus so as to justify restrictions on the right to provide services. Consumer protection is an objective recognised by Community law and falls within the rubric of items which the European Court of Justice has recognised as being justified by

reference to the "general interest". However, there are three important qualifications to this rule:

- It is necessary that secondary legislation not have created an analogous protection for consumers.
- It is indispensable that the national provisions not be discriminatory, i.e. that they not prejudice foreign undertakings or consumers.
- The principle of proportionality must be adhered to, which requires that the restrictions be necessary, appropriate and proportional to the attainment of the legitimate object of regulation on the part of public powers.

The case law has delineated evermore clearly how States must justify any such restrictions. As well, it has recognised some matters as being "particularly sensitive" which thus require regulation and control by public bodies, most notably where insurance has become a "mass" phenomenon. This leads one to think that the same principles could be applied to other financial services, e.g. electronic means of payment. In those cases, regulation or control might be seen as necessary to guarantee to consumers the correct functioning of the system and their freedom of choice.

The real problem that the recent case law throws up is in knowing when a regulation has discriminatory or disproportionate effects. It is here that the law lacks clarity. In the decision of 4 Dec. 1986, the Court insisted that the rule of proportionality forbade the host country to unnecessarily repeat controls which had already been carried out in the country of origin. If there is a monopoly in a service, such a monopoly can have discriminatory

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effects by excluding foreign suppliers\textsuperscript{37} and can no longer be maintained in its present form\textsuperscript{38}.

As far as payment cards are concerned it seems that, Denmark aside, there exists no administrative or contractual regulation in any Member State. Therefore, it is through professional standards (codes of conduct and collective agreements, general contract terms etc.) that a higher level of protection must be achieved\textsuperscript{39}. The result is a certain collectivisation of contracts which gives rise to competition problems\textsuperscript{40}. On the other hand, the simple application of the general law of civil liability is not sufficient for an adequate distribution of risks, as was shown recently in decisions of the Courts of Appeal in Frankfurt and Berlin\textsuperscript{41}.

\textsuperscript{37} This problem was posed by the "Kabelregeling" decision of 28 April 1988, Case 352/85, [1988] ECR 409.


\textsuperscript{39} Cf. Bourgoignie in Stauder (Ed.), Libéralisation des services financiers bancaires en Europe, 1989, pp. 67-86.

\textsuperscript{40} Cf. Reich in Stauder (Ed.), loc. cit., pp 45-66.

\textsuperscript{41} OLG Frankfurt/M, NJW 1990, 1184; Huff 1160; KG, NJW 1992, 1051.
IV. Protection under Private International Law: Some Examples

Has Community law developed the means to obtain uniform, or even minimum, consumer protection in the Internal Market? It is well known that Community legislators are more interested in opening up markets than in protecting consumers. As far as the contractual protection for the consumer of services is concerned the results thusfar attained have not been satisfactory.

1. Art. 5 of the Rome Convention

The almost classic solution of this problem is to be found in private international law. The Rome Convention contains, in Art. 5, a rule protecting the consumer in the contracts he or she concludes. The "passive" consumer as defined in para 2, is entitled to be protected by the mandatory requirements of the law of his or her country of residence, which entitlement cannot be waived by the free choice of laws. It is only by becoming active that he or she may agree to the full application of the laws of the country of residence of the supplier. This rule seems sufficient to guarantee a high level of protection.

Unfortunately, Art. 5 has a too limited practical application in consumer law:

Art. 5 is limited to some consumer contracts and would seem to exclude any consumer credit which is not linked to contracts of sale or for the provision of services. This result goes against the spirit of Directive 87/102 and its principle of minimum protection in favour of the consumer in all credit transactions. It is also in
opposition to the principle of mutual recognition of financial activities by credit institutions in the sense of Directive 89/646/EEC which applies to all lending activities, including consumer credit.

Art. 5 provides no protection against pre-drafted clauses on the choice of applicable law. Art. 8 para 1 makes the validity of choice of law clauses dependent upon the chosen law, not upon the consumer's law of residence even if this is more favourable to him.

Another problem arises where the consumer himself or herself is availing of the rights granted him or her by the Treaty of Rome, e.g. as a tourist moving voluntarily outside his or her home jurisdiction. Recent litigation in Germany demonstrated the uncertainty of the applicable law in situations where a (German!) consumer on holidays in another country is induced, by means of canvassing, to enter into a contract in that country which is however to be fulfilled in Germany by a German supplier but initiated by a seemingly independent seller who closely collaborates with the supplier. Can the seller or supplier have the law of the holiday country applied by virtue of a pre-drafted clause without the consumer having any further links to that country? When one applies the law of the country in which the German tourist spent his or her holidays, in a case in which that country had not implemented Directive 85/577/EEC of 20 Dec.1985 on doorstep selling, it means that the consumer may not rescind the contract. There is a difference of opinion in German courts over

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42 Plender, The European Contracts Convention, 1991, p. 128 at No. 7.15 is not clear on that point.

whether one should really defer to the principle of freedom of jurisdictional choice\textsuperscript{44} or rather one that should mandatorily control the abusive content of these clauses by allowing the \textit{forum} judge to apply the \textit{lex fori}\textsuperscript{45}. Another line of authority strives to give an extensive interpretation to Art. 5 of the Convention and, thereby, to apply it to situations analogous to that of the passive consumer\textsuperscript{46}. It is not sure whether Art. 7 (2) of the Convention on the "application of the rules of the law of the forum in a situation where they are mandatory irrespective of the law otherwise applicable to the contract" can be invoked here\textsuperscript{47}. The most persuasive solution has been suggested in a decision of the Celle Court of Appeal on the direct effect of Directive 85/577\textsuperscript{48}, but has not yet been confirmed by the European Court.

2. \textit{Rules peculiar to insurance contracts}

a) As far as contracts of direct insurance are concerned, there is Directive 88/357 which in Art. 7 sets out the complex rules on

\begin{itemize}
\item \textsuperscript{44} Cf. OLG Hamm NJW-RR 1988, 496; Taupitz, BB 1990, 642; for a critique see Kothe, EuZW 1990, 150.
\item \textsuperscript{45} Reich, CMLRev 1992, 883.
\item \textsuperscript{46} OLG Frankfurt/M NJW-RR 1989, 1018; cf. also Martiny in Münchner Kommentar zum BGB, 2nd Ed. 1990, Art 29 EGBGB no. 18b. The Federal Court, in its judgment of 19.9.90, NJW 1991, 35 did not want to enter upon the question of the legality of the choice of law clause.
\item \textsuperscript{47} Cf. Hoffmann, IPRax 1989, 261: Jayme, IPRax 1990, 220.
\item \textsuperscript{48} WM 1991, 119: in this regard cf. Reich, supra note 3, No. 159.
\end{itemize}
applicable law\textsuperscript{49}. These rules start from the principle that it is necessary to apply the law of the country in which the risk is situated, which is normally the domicile of the policy holder. It, however, admits some other criteria for the applicability of laws, eg (i) for holiday insurance contracts of no more than four months duration the law of the insurer’s establishment, and for (ii) insurance contracts covering buildings and their contents resp. (iii) registered cars the law of the location of the building or registration of the car. What then is the applicable law in the case of a German tourist who wishes to insure his or her holiday home in Spain? The risk is situated in Spain, the policy-holder’s permanent residence is in Germany: the parties to the insurance contract can choose to apply either the law of the country where the risk is situated (Spain) or the law where the policy holder is habitually resident (i.e. Germany), or, indeed, the law of any third country if German and Spanish law so permit. It is obviously the insurer who will impose the applicable law, that is to say, a Spanish insurer can impose the applicability of Spanish law and a German insurer German law. What is the predicament of an English insurer who wishes to insure the risk on similar terms but more cheaply? It is, however, here that Spanish or German law must be chosen. The insurer, therefore, loses its competitiveness and the German consumer is limited in his or her freedom to choose. This result seems to be contrary to the objective of the Internal Market.

The free choice of applicable law is now allowed for all commercial risks, most notably insurance for transport risks, but it may be extended by national legislation, thereby causing further distortions in competition. This is the case in England generally

\textsuperscript{49} Berr, loc. cit., p. 669.
and in Germany with regard to insurance contracts by correspondence.

b) The newly adopted third generation Directives hardly change these results. Free choice is now possible for all commercial risks according to Art. 27. National legislation may allow for total or partial freedom to choose laws. Additionally, Art. 28 provides that "the Member State where the risk is situated shall not prevent a policyholder from concluding a contract with an insurance undertaking authorized under the conditions of Art. 6 of Directive 73/239/EEC, as long as that does not conflict with legal provisions on the general good in the Member State in which the risk is situated."

These rules have been subject to an intense controversy. Some authors pointed to an obvious contradiction between Art. 27 limiting free choice of law and Art. 28 allowing it in the limits of the general good proviso. 50 In my opinion, criticism of this regime should be directed at two points. Firstly, it is quite possible that the provisions on the applicable law can be used as a pretext to partition off insurance markets, as the conditions of competition are also determined by the applicable law which may or may not allow certain exemptions, policy holders warranties and disclosure duties etc. Against the backdrop of the complete lack of Community rules on insurance contracts, national provisions will continue to differ and will, therefore, constitute indirect barriers to the free provision of services. It is not certain that this conflict can be resolved by a broad application of Art. 28 and a narrowing of the rules on applicable law in the aftermath of Art. 27. 51 Such an


51 This is suggested by Roth, RabelsZ (55) 1991, 623 at 657.
interpretation would result in the parties to an insurance contract having a free choice of applicable law, thereby effectuating the freedom of the consumer to receive services at his or her choice from within the entire Community, and to leave the protection of the "passive" consumer by applying the "general good" provisions, particularly those mentioned in Art. 5 of the Rome Convention.

Secondly, national law on insurance contracts is currently not very protective of consumers. In the past, the absence of really protective rules was, at least in Germany, compensated for by the supervision by national authorities of general insurance clauses. The third generation Directives repeal state regulation without, however, having proposed itself a satisfactory alternative. In its Regulation 1534/91 of 31 May 1991\textsuperscript{52}, the Council limits itself to allowing self regulation by the insurers, who may conclude agreements "on the establishment of standard policy conditions", which would be a form of cooperation exempted under Art. 85. Details of the conditions for the group exemption have been spelled out by Commission Regulation 3932/92 of 21 Dec. 1992\textsuperscript{53}. Art. 5 of the regulation exempts agreements which have as their object the establishment and distribution of standard policy conditions for direct insurance as well as common models illustrating the future benefits of a life assurance policy. These conditions may only be used by way of indicative reference and may not contain certain blacklisted clauses, eg imposing on the policyholder in non-life assurance a contract period of more than three years.

\textsuperscript{52} OJ L 143/1 of 7.6.1991.

As a result of this Community approach, *professional standards*, monitored by the Commission, would thus become a legal instrument for establishing future rules on insurance contracts. The deregulation of State law is supplemented by agreements between suppliers. It is not yet sure whether the insurance companies will implement this strategy; they are under no obligation to do so. If they do, it remains to be seen of what happens to the consumer interest being, as it is, a diffuse one without a professional organisation.

c) Finally, Directive 90/619 on direct life assurance has chosen a simpler solution: it imposes, in arts. 2 and 4, the application of the law of the place where the policy holder has his or her permanent residence as the law of the commitment. Still, if the law of that country permits, the parties may choose the law of another country. Thus, in the deregulated insurance market, national contract law is required to guarantee a sufficient level of protection; unless the Community legislators have not imposed minimum contractual rules as a means to "positive" integration (see the next section).

The third Directive on life assurance does not make any changes on the rules concerning applicable law. However, its Art. 28 contains a provision similar to Art. 28 of the "non-life insurance" Directive. It raises the same problems of delineating the relationship between the rules of applicable law and the principle of freedom of choice, which latter principle will only be constrained by provisions adopted by States to protect the *general good*. This limited freedom of choice of laws is the more surprising since already the second Directive 90/619 allowed the active consumer (in a broad sense as policy-holder) to take out
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insurance from wherever he or she wanted. Why should one not allow for free choice of applicable laws?54

3. Instruments of payment

The situation of a consumer who has obtained a payment card is different again. Normally the contract granting the card depends on the place of residence of the company. Only the "passive consumer" will have the privilege that his or her home country laws are applicable. If he or she has obtained a card at his or her own request, through a foreign firm, the law of another country will be applicable. These two legal systems might have different rules on liability in cases of loss or abuse. As a result it is possible that different cards, but belonging to the same consumer, follow different rules and impose different legal obligations.

V. Several aspects of positive integration on contracts for services

1. Mutual recognition and consumer protection: harmony or conflict?

a) The spirit of current Community law is a deregulatory one. The Community wants not only to open the markets for goods and capital but also for services, including financial services. The Community wants to use as the regulating and integrating principle

54 Reich, CMLRev 1992 at 876.
that of the country of the state of origin. This has already been adopted for television services by Directive 89/552/EEC of 3 Oct. 1989\(^{55}\) and for credit institutions since the adoption of the Second Banking Directive (89/646/EEC). The third Directives on direct insurance non-life (92/49/EEC) and life (92/96/EEC) go in the same direction which is followed by investment services through Directive 93/22/EEC.

The basic idea of this principle seems to be simple and clear: every supplier of services legally established in one Member State may pursue his or her professional activity in all other Member States provided he or she follows Community rules and those of the state of origin. The supplier is free to do so via establishment (like the setting up of branches) or via free provision of services across the border. Normally, the Community limits itself to establishing uniform minimum rules, most notably on solvency. At the same time the host state loses its autonomous power of control of professional activities coming from other Member States in the harmonized areas, unless the directives provide for safeguard clauses.

This principle naturally may cause problems for consumer protection in the host country. It imposes the regulatory responsibility for the entire territory of the Community on the state of origin. Even if the substantive law were identical, their application in practice could and should vary considerably amongst member states. Enforcement across borders still remains a "black box". As a result, enterprises can freely choose to set up in the most "lax" country and there may thereby arise a "regulatory

\(^{55}\) OJ L 298/23 of 17.10.89.
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gap" \textsuperscript{56} which endangers consumer interests. Conversely, this approach constrains the regulatory activities of the public authorities of the host country, only permitting urgent measures within the framework of safeguard clauses \textsuperscript{57}.

In the face of this liberalising and deregulatory trend, it becomes urgent that the Community establishes uniform norms and practices ensuring a high level of protection in consumer services. Unfortunately, this development is not very far advanced. It seems easier to open up markets than it is to reach agreement on common rules providing minimum protection.

b) It seems that the Community legislator has recognized that mutual recognition cannot be dismissed from establishing some protective standards for consumers. A first beginning has been done by Directive 92/49 whose Art. 31 requires the insurance undertaking to inform policy-holders, that is, only natural persons, about the applicable contract law and arrangements for complaint handling. Directive 92/96 on life assurance goes further. It contains a right of cancellation for policyholders 14 to 30 days after conclusion of the contract. This right may be excluded for persons not needing protection according to Art. 30.

Art. 31 in connection with Annex II, A and B imposes certain information obligations to be fulfilled in "a clear and accurate manner, in writing, in an official language of the Member State of the commitment" before the conclusion or during the performance of the life insurance contract, namely
- definition of each benefit and each option

\textsuperscript{56} Cf. the reflections of Bourgoignie, \textit{Elements pour une théorie du droit de la consommation}, 1988, p. 265, (the regulatory gap theory).

\textsuperscript{57} Cf. Mattera, loc. cit. pp 175-6.
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- term of the contract
- means of terminating the contract
- means of payment of premiums and duration of payments
- means of calculation and distribution of bonuses
- indication of surrender and paid-up values and the extent to which they are guaranteed
- information on the premiums for each benefit, both main benefits and supplementary benefits, where appropriate
- for unit-linked policies, definition of the units to which the benefits are linked
- indication of the nature of the underlying assets for unit linked policies
- arrangements for application of the cooling-off period
- general information on the tax arrangements applicable to the type of policy
- the arrangements for handling complaints concerning contracts by policy-holders, lives assured or beneficiaries under contracts including, where appropriate, the existence of a complaints body, without prejudice to the right to take legal proceedings
- law applicable to the contract where the parties do not have a free choice or, where the parties are free to choose the law applicable, the law the assurer proposed to choose.

Throughout the term of the contract, changes in policy conditions relating to the first nine items must be communicated to the policy-holder. Every year, he or she must get information on the state of bonuses.

2. Banking services and means of payment

a) As far as banking services are concerned, the Commission had originally proposed mutual recognition of financing
techniques\textsuperscript{58}. This principle was strongly opposed by consumer organisations, particularly the CCC. It, therefore did not become part of the final Directive 89/646/EEC. Recital 16 only provides that "... the Member States must ensure that there are no obstacles to carrying on activities receiving mutual recognition in the same manner as in the home Member State, as long as the latter does not conflict with legal provisions protecting the general good in the host Member State". The final version of Art 21(5) no longer mentions mutual recognition of financing techniques, but only refer to financial activities like lending and deposit which come under the mutual recognition principle according to the Annex. It furthermore provides for the application of rules of the host state which have been adopted for the general good. It is certain that provisions which ensure effective protection for consumers against, for example, usury, are for the general good, and thus can be invoked against the business activities of foreign banks, even where these activities are allowed by the State of origin.

b) With regard to the rules on electronic transfer of funds (including payment cards), the Member States, with the exception of Denmark\textsuperscript{59} have not adopted any protective measures of either a regulatory or a contractual nature. There exists in the United

\textsuperscript{58} Cf. the criticism of Allix in J. Mitchell (Ed.), The Consumer and Financial Services, 1990, pp. 130-3.

\textsuperscript{59} The Payments Cards Act No. 284 of 6 June 1984.
States a code on "Electronic Fund Transfer"⁶⁰ which has served as a basis for discussion in the Community. Initially, the Commission wanted a directly interlinked system of electronic fund transfer. It hoped that such a system would come about not by act of law but by voluntary cooperation of banks and other financial institutions. The Commission can use its exempting powers under the rules on competition, especially Art. 85 (3), for such cooperation agreements. This Community legal regime has, unfortunately, not yet been set up. It is still at the Member State level that efforts are being made to create means of payment, for example by using Eurocheque cards to withdraw money from automatic tellers or paying directly through point of sales (POS) machines.

As regards protective rules for consumers, most notably in the case of loss or abuse of the card, the Commission had initially proposed a Directive establishing uniform standards. The opposition of the banks prevented the draft becoming law. Later on, the Commission chose the means of recommendation. The first is dated 8 December 1987⁶¹, the second (88/590/EEC) 17 November 1988⁶². The first recommendation limited itself to rather technical aspects. The second is interesting as it contains some protective rules which, according to the text, should be

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⁶¹ OJ L 365/72 of 24.12.87

adopted by the Member States or financial institutions before the end of 1989, thereby allowing for uniform use of these means of payment. European banks set up two "Codes of Conduct" for payment cards of 14.11.90 and for POS-services of 16.9.1991\(^{63}\). The recommendation provides that a consumer be protected against abuse if he or she has notified a central network of the loss of the card. Before such notification, the liability of the consumer should be limited "to a ceiling of the equivalent of 150 ECU per case unless he or she is proven to have acted with extreme negligence or fraudulently", Art. 8.3. This recommendation tends to follow the American model which differentiates consequences according to the time of notification.

It will be interesting to find out how this recommendation has been put into operation in the Member States, either by the legislature or the regulatory authorities, or inserted into the general contractual terms used by the financial institutions which promote these means of payment\(^{64}\). It must be pointed out that the recommendation, even though it is binding neither vis-à-vis Member States nor individuals, still has some legal effects because Member State courts are under an obligation to take account of them in a litigation concerning the interpretation of implementing State or Community legislation.\(^{65}\)

It must be added that in the FRG both private and public (i.e. savings) banks substantially altered the terms under which these

\(^{63}\) Cf. Favre-Bulle, loc.cit. annex 3 & 4.

\(^{64}\) Knobbaut-Bethlem, A survey of the implementation of the EC recommendation concerning payment systems, 1990.

cards were issued. It is interesting to note the difference between the two approaches. Private banks followed the example of the recommendation in broad terms by limiting the liability of the consumer before notification to a charge of 10% of the loss; this term is applicable independently of the gravity of fault on the part of the consumer. Savings banks, on the other hand, exonerate the consumer from all liability up to a sum of 6,000 DM provided there was no gross negligence on his or her part and that he or she made the notification as quickly as possible after the loss. Both terms have substantially improved the consumer's rights. However, it must not be forgotten that the risks to the customer of a private bank can be far greater than 150 ECU. As for the terms issued by savings banks, the liability depends on the gravity of fault on the part of the holder of the card, that is, on his or her respecting the duties imposed on him or her as regards the safekeeping of the card and protection of the secret PIN.

The research project has been extensively concerned how the Recommendation has been put into effect in the countries studied. Most notable is the British example where banks have adopted a code of conduct which implies voluntary self-regulations of the participating banks. Implementation is assured through the institution of the Ombudsman who will consider the code of conduct as expression of good banking practice.

The situation in Spain and Greece is subject to criticism. An exhaustive study on the situation in Spain shows the unsatisfactory state of law and practice. Credit card companies and credit institutions which issue cards may all adopt their different standards and widely use exclusion clauses to limit their liability. There is some indirect control by the Bank of Spain's complaint

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66 See the critique of Derleder, JZ 1990, p. 84.
service which uses Commission Recommendation 88/590/EEC, just like in the U.K., as an expression of good banking practice and will therefore apply it in complaints before it. However, the service is only available to customers of banks in a narrow sense, not to customers of other institutions issuing credit cards. In Greece, there has been no activity so far to implement even indirectly Community Recommendation 88/590. Details can be seen in the national reports.

3. **Canvassing of services**

Directive 85/577/EEC\(^{67}\) extends protection to the consumer against doorstep selling of goods and services by giving him or her an unconditional right "to renounce the effects of his undertaking ... within a period of not less than seven days...", Art. 5. "The consumer may not waive the rights conferred on him or her by this Directive", Art. 6.

The application of this directive to financial services raises two problems. First, it excludes insurance contracts from its ambit without justifying this privilege for insurers. Art. 30 of the third Directive life provides from 1st July 1994 on for a general right of cancellation wherever the contract was concluded. There is no similar provision for non-life insurance which may however be introduced by the national legislator like (to a limited extent) in Germany.

Second, the rights so conferred by the Directive are effective only after transformation into national law. Unfortunately, many **Member States are found wanting in their fulfilment of Community**

\(^{67}\) Cf. note 40.
duties. A suggestion has been made to invoke the so-called doctrine of "direct effect of directives". The complexities of this question cannot be gone into here. The case law of the European Court allows direct effects only in the vertical relationship of citizen and public administration, and not in the horizontal relationship of citizen. However the Directive on doorstep selling involves the legal relations of "business persons" and "consumers", i.e. horizontal relationships. In recent decisions, the Court has gradually modified its original position and has sought a solution in the interpretation of national law by invoking the practical effectiveness of directives. 68

In the meantime, the Directive has been implemented in all Member States.

Third, the Directive is not applicable to providing financial services by distance selling techniques. A Commission Proposal of 7 Oct. 1993 has not yet been enacted69. There is some discussion of exempting certain financial services from it.

4. **Consumer credit**

Consumer credit has been a prime concern of consumer protection policy ever since credit became easily available to consumers. Legislation first turned to credit combined with the

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69 OC C 318/18 of 15.11.93.
sale of goods or the provision of services. The idea of the early instalment legislation, for instance in Germany and later in Belgium, was to protect the consumer in case of repossession and to prohibit certain unfair clauses. The more the provision of credit became common by banks, credit unions and loan associations, the more it was separated from a transaction aiming at the sale of goods or the provision of services. Consumer credit became a merchantable good or service of its own and was marketed to consumers for any purpose. Therefore, consumer credit legislation had to take a broader approach and cover all forms of credit, whether connected or not with the sale of goods and services. This approach, as far as EC countries are concerned, was first used by the comprehensive British Consumer Credit Act of 1974. France followed suit in 1978. Other Member States extended their legislation to cover credit agreements beyond the transfer of property.

The approach taken by Member State legislation and court practice varied. The forms of credit covered by legislation or court practice differed widely. Most legislation agreed on giving the consumer certain basic information rights, especially about the total cost of credit, but used different methods of calculating the costs. Additional provisions in some Member States concerned the doorstep marketing of credit, securities and guarantees, clauses on default and recovery. Member States' national law therefore differed widely.

The Commission's programmes on consumer protection proposed a harmonisation of consumer credit legislation in the EC context. The Commission published its first proposal on consumer—
credit in 1979\textsuperscript{70} and modified it in 1984\textsuperscript{71}. The proposals were mostly concerned with consumer information. Its approach was new insofar as it was to cover all types of consumer credit, with the exception of credit on immovables, small credit and credit agreements exceeding a certain sum of money (30,000 ECU). As a basic European consumer right, the proposals provided for a uniform method of calculating the annual percentage rate of charges which was to be part of credit offers and to be included in consumer credit agreements. Thereby the European consumer was able to compare credit offers within the common market. Some other provisions concerned unfair credit practices and protection of the consumer against certain clauses. Protection, in the words of the Commission official responsible, "principally meant informing". The problem of consumer indebtedness was not covered.

After protracted discussions, the Council adopted the Directive of 22 December 1986 87/102/EEC on the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit\textsuperscript{72}. The considerations justifying the adoption of the directive did not so much relate to genuine consumer protection objectives as to harmonising distortions of competition between providers of credit in the common market due to different Member State legislation. They stressed the basic right of the consumer to receive adequate information on the conditions and cost of credit and his/her obligations. This was to be calculated by the annual percentage rate of charge which,

\begin{itemize}
\item \textsuperscript{70} OJ C 80/4 of 27 March 1979.
\item \textsuperscript{71} OJ C 183/4 of 10 July 1984.
\item \textsuperscript{72} OJ L 42/48 of 17 February 1987.
\end{itemize}
however, could not be harmonised in the present directive; therefore, Directive 90/88 was enacted\textsuperscript{73}. Its basic philosophy rests upon consumer protection through increased information.

Article 1 of the directive defines the basic notions for its application. The concept of the consumer is defined narrowly, as we have seen in the doorstep directive and the Rome Convention. The notion of credit is used very broadly, covering any type of deferred payment. The directive was to cover any type of credit agreement, but excluded certain arrangements where consumer protection was not deemed necessary, for instance, credit granted or made available without payment of interest or any other charge. Small credit (less than 200 ECU) or large credit (more than 20,000 ECU), credit secured by mortgages on immovable property, credit in the form of advances on current account granted by a credit institution (other than on credit card accounts) were all excluded, except for some basic information requirements. One must conclude from this paragraph that credit card accounts are covered insofar as the consumer has to pay charges for overdrafts.

The directive insisted that the consumer be informed about the annual percentage rate of charge in the agreement, but not necessarily in the advertising (unless the advertisement made reference to interest rates or costs of the credit). The credit document was also to include some other information pertinent to the consumer. The calculation of the annual percentage rate of charge was left to the Member States or to further efforts at harmonisation (Article 5). Credit on running accounts was subjected to less stringent requirements. There was no provision against a rise in interest rates during the running of the account (Article 6 para 2).

\textsuperscript{73} OJ L 61/14 of 10 March 1990.
The directive also contains certain provisions on unfair credit terms without making clear its philosophy. It does not cover the different types of abuse which occur in the marketing of credit and collection of debts. Again it can be seen that the original proposals were watered down in the directive. It is left to the Member States as to how they guarantee consumer protection, for instance against repossession (Article 7), assignment (Article 9), granting security or making payments by means of bills of exchange (Article 10), and third-party financing (Article 11). On the other hand, the directive imposes an obligation upon the Member States to ensure adequate legal protection. Article 12 aims at guaranteeing the consumer some sort of public control over the behaviour of credit institutions, but leaves is to the Member States whether they choose an authorisation procedure, an inspection or monitoring of the activities or the establishment of a complaints procedure. On the other hand, the Member States are under an obligation to implement the provisions. They cannot simply abstain from their Community obligations. This is especially true for complaint handling, which is not officially recognised by many Member States.

The directive which has a minimum character had to be implemented by the Member States by 1 January 1990. The process of implementation has been slow. Germany only implemented it on 1 January 1991 by the Verbraucherkreditgesetz which extended protection to default and credit brokerage. Greece has enacted the directive by Ministerial Decree 7.21/3/91. Other Member States have not done so at all, like Spain. Because of its broad and imprecise formulations, the directive does not confer specific rights upon consumers and cannot be construed as having direct effect. It may only be used to interpret member State law.
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It is unclear how the directive relates to the banking Directive 89/646 which aims at opening the financial service markets by permitting credit institutions (with the exception of finance companies, credit unions etc.) to operate on a single EC licence. As far as consumer credit is provided by banks, both documents must be coordinated. The logic of a single licence means that every bank may provide credit throughout the EC without having to obtain an additional licence. There is no conflict between the directive insofar as the obligation to provide the annual percentage rate of charge is concerned.

It is most regrettable that the problem of consumer debt has not even been mentioned in the directive. Under the new Council Resolution of 1992 the Commission is studying the feasibility and jurisdiction to take steps in combatting consumer overindebtedness. A joint project of different European researchers including this author has been prepared under the direction of N. Huls and contains proposals on establishing a debt counselling system in the Community, including the possibility of a discharge to good faith debtors after 4 years of fulfillment of a debt settlement plan.


The EC-Commission had announced, in its first and second consumer programmes, Community action in the field of unfair contract terms. It took however nearly ten years before a first proposal was published\textsuperscript{74}. It was preceded by a careful study on the comparative law of Member States and other jurisdictions on

\textsuperscript{74} OJ C 243/2 of 28 Sept. 1990.
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the comparative law of Member States and other jurisdictions on unfair contract terms, pointing to substantial differences both in the theoretical approaches taken and in the remedies provided by national legislatures. The 1990 proposal met criticism from different angles. Both the Economic and Social Council of the EC and the European Parliament proposed substantial amendments.


This paper will briefly look at its importance for Community integration and regulation of financial services. It should be emphasized that the proposal if enacted would be applicable to all types of consumer contracts on financial services in a broad sense, including deposits, investment, insurance, payment and credit. Most important is the confirmation of the principle of transparency in Art. 4 (2):

"Assessment of the unfair nature of the term shall relate neither to the definition of the main subject-matter of the


77 OJ C 159/34 of 17 June 1991.


80 JCP 1992, 469.
contract nor to the inadequacy of the price and remuneration, on the one hand, as against the services or goods supplied in exchange, on the other, insofar as these terms are in plain and intelligible language."

Recital 19 expressly refers to insurance contracts insisting that "in insurance contracts, the terms which clearly define or circumscribe the risk and the insurer's liability shall not be subject to such assessment (regarding fairness, NR) since these restrictions are taken into account in calculating the premium paid by the consumer".

Art. 3(3) of the Directive in connection with the Annex contains an "indicative and non-exhaustive list of the terms which may be regarded as unfair", thus dramatically changing the original approach of the Commission and the Parliament which wanted to establish a "non-exhaustive list of blacklisted clauses."

It is interesting to note that financial services enjoy some privileges in comparison with other contracts for the supply of services:

- A supplier of financial services may reserve the right to terminate unilaterally a contract of indeterminate duration without notice where there is valid reason provided that the supplier is required to inform the other contracting party/parties thereof immediately.

- A supplier of financial services may reserve the right to alter the rate of interest payable by the consumer or due to the latter or the amount of other charges for financial services without notice where there is valid reason, provided that the supplier is required to inform the other contracting party/parties thereof at the earliest opportunity and that the latter are free to dissolve the contract immediately.

On the other hand, certain "greylisted" clauses may well be applicable also to financial services, e.g. clauses
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- excluding or limiting the legal rights of the consumer vis-à-vis the supplier in the event of total or partial non-performance or inadequate performance of any contractual obligations,
- limiting the supplier's obligation to respect commitments undertaken by his agents,
- requiring any consumer who fails to fulfill his obligations to pay a disproportionately high sum in compensation, without requiring any supplier who fails to fulfill his obligations to pay a similar sum,
- excluding or hindering the consumer's right to take legal action or exercise any other legal remedy, particularly by requiring the consumer to take disputes exclusively to arbitration, restricting the evidence available to him or imposing on him a burden of proof which, according to the applicable law, should lie on another party to the contract.

It remains to be seen how the proposal will be enacted in the Community law making procedure and how Member States will implement it.

Member States have time till 1 January 1995 to decide how they want to implement Directive 93/13/EEC. Article 189 para 3 of the EC Treaty leaves them the freedom of choice of form and methods, but the directive is binding as to the result to be achieved. Most important will be a correct implementation of the transparency obligation which has been set out in Articles 4 and 5 of the Directive. This obligation to inform the consumer in plain, intelligible language about the contract terms includes all parts of the contract, eg. on price and its subject matter. This is particularly important for financial services. Therefore, the consumer must be informed about all charges, commissions and costs of a financial service notwithstanding specific legislation on that point as in consumer credit law. As far as the subject matter of the contract is concerned, it is particularly important that insurance
contracts state clearly the terms of cover as well as warranties, disclosure duties and other obligations of the policy holder. Since insurance policies do not undergo government screening any more from 1 July 1994 on, it is the insurer itself which has to safeguard plain and intelligible policy terms. This may also relate to the language employed in the contract, especially vis-a-vis consumers who do not understand the language ordinarily used for the transaction. A specification has been made to that regard in the Third Directive on life insurance. It requires that certain information must be communicated to the policy holder in a clear and accurate manner, in writing and in one official language of the Member State of the commitment. Nonetheless, this information may be set out in another language if the policy holder requests and the law of the Member State so allows, or if the policy holder is free to choose the applicable law.

Recommendation 88/590 on payment cards require that, when it comes to the information to be given to credit card holders, Member States which have general legislation governing the use of languages in consumer relationships will apply the linguistic requirements of this legislation to this area equally. A recent study by BEUC has criticized the haphazard approach of Community law toward language requirements which are an important part of consumer protection.

The legal character of the annexed list is subject to some doubt. Since the Council has made it expressly clear that it is a non-mandatory, but merely an indicative and non-exhaustive list, it cannot be regarded as something like a blacklist known from German law on general contract terms. On the other hand, certain

81 BEUC, Language requirements in consumer related legislation with the European Community, 1993.
provisions want to specify the concept of abuse in Article 3 and therefore the annexed clauses must be regarded as giving evidence of abuse. 82 This is the more necessary since there are Community-wide standards of clauses which should not figure in preformulated contract terms. Especially financial services like payment cards, consumer credit and life assurance will be marketed cross-border and must therefore contain similar terms, not withstanding rules on applicable law as mentioned above.

A vivid debate is in the offing in the Member States on how to implement the Directive. A proposal of the British Department of Trade and Industry opts for a statutory instrument which would be applied alongside with the Unfair Contract Terms Act of 1977. Schedule 1(e) would exclude the application of the Regulation to the terms of contracts of insurance which define and circumscribe the insured risk and the insurer's liability. This exclusion is somewhat problematic because not the Directive itself, but only the recitals contain a similar exclusion which is also phrased in misleading terms in the different official languages of the EC.

In Germany, there is a lively discussion under way whether to implement the Directive by a specific act as has been done with regard to the consumer credit or the doorstep directives, or whether the German AGB-Gesetz of 1976 should be changed. The majority of legal writers prefers a solution whereby the AGB-


83 In this sense, Hommelhoff/Wiedenmann, ZIP 1993, 562; cf. also Damm, JZ 1994, 161.
Gesetz could be adapted to the specific requirements of the Directive\textsuperscript{84}. There is yet no official proposal.

Greece, in its Consumer Protection Act of 1991, had adopted the then Commission proposal of 1990 without having regard to later changes. Greek law would therefore have to amend its legislation to make it conform with the newly adopted text of the Directive.

Spain finally has a broad provision, namely Article 10 of the Act to protect consumers and users (LGDCU), but which does not play any role in legal practice. Therefore, some type of implementation of Directive 93/13 will have to be done by the Spanish legislator.

6. **Insurance policies**

The third directives non-life and life insurance contain very few provisions aimed specifically at consumer protection. They leave it to the national legislator, in the framework of the rules on applicable law and the general good proviso of Art. 28, to provide for adequate protection of policyholders through insurance contract law.

An interesting instrument is Commission Regulation (EEC) No. 3932/92 of 21 Dec. 1992 on the application of Art.85 (3) of the Treaty to certain categories of agreements, decisions and concerted practices in the insurance sector\textsuperscript{85}. Title III lists some

\textsuperscript{84} Ulmer, EuZW 1993, 337; Heinrichs, NJW 1993, 1817; Eckert, WM 1993, 1071.

requirements of standard policy conditions for direct insurance which are collectively used by insurance companies. Art. 6 (c) requires that these policies are accessible to any interested person and provided simply on request. Art. 7 (1) (g) forbids clauses which impose on the policyholder in the non-life assurance sector a contract period of more than three years - a provision which flatly contradicts German insurance contract law which allows policies up to ten years (!) under certain conditions. Art. 8 contains a general rule on non-discrimination.

The problem of these provisions is that, in the case law of the European Court, they do not impose mandatory requirements on insurance policies, but are only conditions for exemption. 86 They therefore cannot be enforced by policy holders against insurers.

Conclusion

This paper can only give a glancing account of the state of development of the right to consumer services, especially financial services, in the Community. At the present time, the objective of protection is certainly secondary compared to the objective of integration so as to achieve the Internal Market. This will still take some time, especially for insurance services given the delays for implementation of the directives and the transitional rules granted to some "new" Member countries. Adequate protective standards still have to be developed. Much depends on the enactment and implementation of the unfair terms directive. The present state of affairs can only be tolerated for a very short period. The

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Norbert Reich

Community must reach a uniform and heightened level of consumer protection within the now theoretically single and open market the sooner the better.
JOHN CECIL VAN AKEN

COMMUNITY REGULATION ON BANKING SERVICES

I. The Liberalisation of Financial Services

A. General Strategy of Financial Integration

The recent legislation related to banking law at EC level is inspired by the Community strategy for the integration of the financial sector. European banking law thus has to be categorized into the two major components of that strategy, namely financial as well as monetary integration.¹

The latter element, concerned with the exchange rate stability among national currencies, can be achieved notably through the political enforcement of the European Monetary System and the widespread use of the ECU.

Financial integration, on the contrary, is based on the liberalisation of financial services (banking, securities, insurance) and the gradual removal of remaining controls on capital movements.

An efficient and open banking market therefore is considered an indispensable part of liberalisation of financial services. This view implies the creation of a unified market in which banks will have the right to establish their branches or subsidiaries and to provide

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¹ See for the following Zavvos 25 CMLRev [1988] 263 et seq.
the whole range of banking services (without establishment) throughout the Community.

The Commission has acknowledged the increasingly important role which financial services play in the Community's economy: inter alia, they have effect to the manufacturing industry which is in need of cheap and competitive financing. Higher costs of financing or insurance will impede production as well as affecting private households which will have to pay more or accept lower standards of financial services.

In this respect it is recognised that the European consumer should be able to benefit from a wide choice of competitive financial services available throughout the EC.

As to the understanding of EC legislation on banking in context with consumer protection, however, one must take into account that consumer interests are not deemed to be essential for the achievement of integration, albeit liberalisation will have certain effects as to the consumer's choice.

The above-mentioned objectives are laid down in the EEC Treaty concerning the integration of financial services markets in general (Art. 3 c) and have been reiterated by the Commission in its 1985 document "White Paper"\(^2\) for the completion of the internal market which has been endorsed in the Single European Act.\(^3\)

\(^2\) Doc. COM (85) 310 final.

\(^3\) As promulgated in Bulletin of the EC, Suppl. 2/86 = CML.Rev 23 [1986] 813 et seq.; for relevant comment see e.g. Ehlermann, CML.Rev 24 [1987] 361 et seq.
B. **Capital Movement**

The liberalisation of capital movement, which shall not be dealt with here in depth, is nevertheless closely linked to the development of banking regulation with regard to the freedom to provide services. Though the former view that financial services legally are subject to the movement of capital has been rejected, the internal market of financial services will only function if the Community-wide proliferation and accessibility of services is guaranteed by the free movement of capital.

As to legislative efforts, the Community already back in 1962 has adopted measures requiring the Member States to allow free movement of capital for direct investment. In the end of 1986 liberalisation has been extended to long-term transactions, bond issues and unquoted securities.

Finally, remaining controls will be eliminated through the implementation of the Third Directive 1988.

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C. Legal Basis for the Integration of Financial Services

The implementation of the basic freedoms of establishment and provision of services (Arts. 52, 59) is governed by the procedures laid down in Art. 57 II (Art. 66). This specific legal basis precedes Art. 100a as an instrument of implementation.\(^8\)

Measures taken for implementation are directives, recommendations or regulations per Art. 189 EEC Treaty. As regards the relation of directive and recommendation, the Commission in respect of banking harmonisation has stressed that recommendations are considered to impose factual obligations on the Member States since non-compliance is responded with the preparation of proposals for (compulsory) directives.\(^9\)

The legal basis chosen for the implementation of Treaty provisions is decisive for to what extent the Member State law on financial services is being harmonised, particularly whether elements of consumer protection may be included. Furthermore, the legal basis and thus extent of harmonisation will shape the remaining scope of competences for the Member States to regulate areas of law as far as these may be subject to measures taken at Community level.

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\(^8\) From all Directives adopted in the banking sector only Directives 87/102/EEC and 90/88/EEC are based on Art. 100, 100a forming a consumer protection measure held to be necessary for the functioning of the internal market. Both measures thus were not considered to be necessary for the opening up of national markets within the EC in terms of Art. 52, 59 EEC Treaty.

Directives adopted under Art. 57 II (66) are supposed to ease the pursuit of transborder business within the EC by harmonising differing legal requirements for market access.

The EC objective of coordination consequently should allow for mutual recognition of authorisation and supervisory schemes established by Member State legislation. With regard to political enforceability and practical issues, it is conceivable that the EC legislator tries to achieve the prior conditions of mutual recognition at a very low degree of coordination. It has to be pointed out that mutual recognition pursuant to the Treaty does not necessarily call for prior coordination at EC level.\(^\text{10}\)

On the other hand, under the EC Treaty it is not understood as an instrument to level down different legislation though it may result in deregulation or have similar effects.

For the purpose of integration, the adoption of the mutual recognition-concept has turned to be the most important step for the completion of the internal market.

\section*{II. Community Measures of the First Generation}

\subsection*{A. First Attempts}

Back in the years of 1969 to 1972, the Commission proposed a banking directive for the first time.\(^\text{11}\) This preparatory act

\footnotesize
\begin{itemize}
\item \(^{10}\) See Groeben et al./Troberg, Kommentar zum EWG-Vertrag (4th ed. Baden-Baden 1991), Art. 57, No. 5.
\item \(^{11}\) Document 14/508/72.
\end{itemize}
contained all essential topics considered to form a complete system of banking supervision at EC level.\textsuperscript{12}

However, that characterization of a comprehensive regulatory framework caused opposition related to the proposal's political feasibility. Very soon it became obvious that harmonisation could not be achieved in one step. A single concept of supervision moreover had to regard the different accounting systems as a vast number of capital requirements and solvency rules pursuant to the draft directive were dependent on balance sheets.\textsuperscript{13}

The proposal finally failed with the access of the United Kingdom, Ireland and Denmark to the EC in 1973, confronting the other Member States with a considerably more liberal system of banking supervision.

\textbf{B. Directives from 1973 to 1983}

The guarantee of freedom from discrimination on grounds of nationality in Art. 52 was realized by Directive 73/183/EEC.\textsuperscript{14} Among other things, the requirement of increased own funds for foreign institutions as well as a temporary limitation of licenses granted to foreign banks were removed. Authorisation no longer

\textsuperscript{12} Hellenthal, Das Bankenaufsichtsrecht der Europäischen Gemeinschaft, Berlin 1992, p. 40.

\textsuperscript{13} For an overview see Troberg, Umfeld der Bankrechtkoordinierung und allgemeine Grundlagen, in: Rehm (ed.), Perspektiven für den Europäischen Bankenmarkt, Bonn 1989, p. 35.

\textsuperscript{14} O.J. 1973 L 194/1.
was linked with the requirement of becoming a national of the host
country.

Introduction of harmonised conditions for authorization was
achieved by Directive 77/780/EEC (first directive with regard to
banking coordination). The Community-wide introduction of
compulsory authorization made up one of the landmarks for
further integration. Furthermore, first criteria were set up to
harmonise the ongoing control of banking business.

Supervision on a consolidated basis should enable the authorities
to make a more soundly-based judgment in respect of the financial
situation of credit institutions. In order to assess the financial
situation of foreign-owned subsidiaries the consolidation was made
in respect of the parent undertaking, thus falling into the
supervisory jurisdiction of the Member State where that
undertaking was established.

Thereby the EC legislator has applied the principle of home
country control for the very first time. Unlike nowadays that
kind of home country control was not based on harmonised rules
for consolidation. The Member States thus could apply their

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see Bester, Aufsichtsrechtliche Kontrolle internationaler Bankkonzern,
Kön 1986.


18 Art. 3 III of 83/350/EEC, ibid.

19 Hitherto it has only been mentioned as an objective of EC policy, see
national supervisory schemes supplemented by a system of close cooperation aiming at mutual information across borders.

Meanwhile the Directive 83/350/EEC has been replaced and the scope for consolidated supervision has been widened as well as the methods of consolidation have been coordinated.\(^{20}\)

C. The White Paper of 1985

The Commission’s programme and time-table on the completion of the internal market was laid down in the White Paper of 1985.\(^{21}\) Regarding banking supervision the Commission has adopted a new approach, following the strategy successfully applied in the goods sector.\(^{22}\)

The new approach to banking integration was characterized by four principles\(^{23}\):

- Harmonisation of essential standards for prudential supervision for the protection of investors, depositors and consumers;
- Mutual recognition of the way in which each Member State applies those standards;
- Based on the first two elements, home country control and supervision of financial institutions operating in other Member States;


\(^{22}\) Case 120/78, - Rewe v. Bundesmonopolverwaltung für Branntwein - [1979] ECR 649 ("Cassis de Dijon").

Pursuant to the principle of home country control, a single licence for credit institutions granted by the home country and valid throughout the Community.

Community measures taken in order to complete the internal market are not set out to achieve the total harmonisation of Member State law. In order to avoid striking disparities between legal orders Community action should grant a minimum level of harmonisation.

D. **Survey of Directives since 1986**

In December 1986 the Council adopted a Directive on the annual accounts and consolidated accounts of banks and other financial institutions\(^{24}\), thereby qualifying the 4th and 7th Directive on company law in respect of the banking sector. It formed an important basis for banking supervision and intends to ensure the comparability of annual accounts across borders.

Two more measures were taken in 1986 when the Commission set up two recommendations concerning large exposures and the introduction of deposit guaranty schemes. The latter one\(^ {25}\) will be dealt with separately in this paper.

The Commission's recommendation on controlling large exposures of credit institutions\(^ {26}\) dealt with the limitation of credit risks caused by concentrations on one or a group of clients. By the end of 1992 the Recommendation has been transformed into a


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legally binding Directive containing upper limits for the lending business. The principle of control on a consolidated basis was taken over from Directive 83/350/EEC. Hence, the recommendation also contained elements of the home country control principle.

III. The Second Banking Coordination Directive

A. Preliminary Remarks

The most important year for the coordination of banking supervision was 1989 since that year three directives being essential for the completion of the internal banking market passed Council legislation.

Besides the Second Banking Coordination Directive 89/646/EEC building a framework for the implementation of the White Paper approach, the EC legislator took supplementing measures by two other directives about own funds and on a

27 Council Directive 92/121/EEC, O.J. 1993 L 29/1; contrary to the limit of the Recommendation the Directive now has limited the amount per credit and group of beneficiaries to 25% of the credit institution's own funds; the limit for all large exposures has retained the Recommendation's approach and may not go beyond the upper limit of 800% of the own funds.

28 Supra, loc. cit. (note 17).


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solvency ratio for credit institutions. All directives were to be implemented by the 1st of January 1993.

The Second Banking Directive contains the leading principles for EC supervisory banking law. It is set out to implement the essential harmonisation necessary and sufficient to achieve mutual recognition of authorizations and supervisory schemes. Thus the granting of a single license valid throughout the Community is made possible and allows for the introduction of home country control.

B. Structure

The Second Directive consists of six titles subdivided into 25 articles:

Title I: Definitions and Scope of Application (Arts. 1-3);

Title II: Harmonisation of Conditions Relating to the Taking up of Business (Arts. 4-7);

Title III: Third Countries (Arts. 8-9);

Title IV: Harmonisation of Conditions Relating to the Pursuit of Business (Arts. 10-17);

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32 Contrary to Art. 12 I of Council Directive 89/647/EEC (1.1.1991) it is commonly considered that all Directives will be implemented by one date; see Art. 24 I of 89/646/EEC, Hellenthal, op.cit. (note 12), at p. 50.

Title V: Provisions Relating to the Freedom of Establishing and Providing Services (Arts. 19-21);

Title VI: Final Provisions (Arts. 22 - 25).

In order to understand the range of harmonisation after the Second Directive has been adopted, one must not forget that several provisions of the First Directive are still in force as long as the latter has not formally been replaced by the 1989 Directive.

C. Definitions and Scope

1. "Credit Institution"

Pursuant to Art. 2 I, the Directive is applicable to all credit institutions. For a legal definition Art. 2 no. 1 refers to the First Directive of 1977 meaning that the narrow scope of application has been retained. The definition of the term "credit institution" essentially shapes the Directive's scope of application (Art. 2 I).

As the Directive stresses the regulation of institutional matters, the definition of what under the Directive is a "credit institution" is of outstanding significance.

The Directive on the one hand introduces the principle of mutual recognition for financial institutions in order to implement the basic freedoms laid down in Arts. 52, 59. On the other hand, the existence of a definition related to the personal scope of application in this respect reveals that not every institution at this stage shall enjoy the benefits of this implementation.

34 Horn, ZBB 1989, 107, at p. 111.
Community Regulation on Banking Services

Only a restricted number of institutions shall be governed by the Second Directive, although every self-employed business is principally subject to the freedom of establishment and provision of services.

The definition as a consequence already indicates the extent of (proposed) integration at least necessary in respect of completing the internal market.

For the purposes of EC banking supervision of credit institutions the EC legislator has applied a uniform definition as it is used in the Directives on own funds (Art. 1 II) and on a solvency ratio (Art. 1 I).

Art. 1 no. 1 refers to the definition already given in the First Directive (Art. 1):

"...an undertaking, whose business is to receive deposits or repayable funds from the public and to grant credits for its own account".

Although the unchanged adoption of the 1977 definition was highly criticised during the legislative process, the Second Directive has not widened this approach. Thus, an institution is subject to the Directive only if it carries out both the (passive) deposit as well as the (active) lending business.

The comparatively narrow character of this solution becomes obvious as one regards for instance the enumeration adopted in the German KWG § 1. To fall within its scope an institution only has to cover one of the activities enumeratively listed in nos. 1 to 9 of that provision. The Second Directive methodically deviates from this approach as it does not begin with listing the activities which should fall within its scope.
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While the banking system in the EC Member States can be divided into universal and specialised institutions, the narrow definition of the Second Directive does not include specialised institutions as e.g. leasing banks or building societies which do not take deposits from the public, as little as broker firms which operate in the field of security trading.

Where an institution does not fulfil the cumulative conditions mentioned above it is excluded from all positive effects arising from banking coordination through the Second Directive. Not being subject to the advantages of a harmonised supervisory system, i.e. the principle of mutual recognition and single license, those specialised institutions on the other hand do not share the same requirements for authorization and pursuit of ongoing business as imposed on credit institutions.

As a result, even if such a "finance institute" carries out the same operations like a credit institution it will not be governed by the Directive. Consequently, there will remain different regimes for the same sort of banking activities in the future.

This prospect is presumably emphasized by those Member States which in their own jurisdiction up to now have preferred a so-called "broader view" towards the scope of banking regulation. They have argued that prudential supervision does not only cover the protection of savings and deposits but also has to safeguard the stability of the banking system in its entirety.


36 Bader, EuZW 1990, 117, at p. 119.
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As the specialised institutions cannot be seen isolated, their failure obviously concerns the entire banking system. Several Member States, particularly Germany and France, consequently wanted to see those specialised institutions within the scope and therefore have opted for a wider definition.

Despite of the likely result that unequivalent legal treatment will cause distortions to the competitive situation, the adherents of the so called "narrow approach", as e.g. the Netherlands and the UK, put emphasis on the more traditional task of supervision, namely to confine the regulation to the protection of depositors' interests.

As a result, the Directive's supposed objective is to reconcile those contrasting attitudes\(^{37}\) towards the extent of banking regulation having a predetermining effect on integration of financial services. However, the Directive in its definition apparently has followed the narrow regulatory concept: the Directive's application to specialised "finance institutions" not being credit institutions is only provided for in exceptional cases (Art. 18 II of 89/646/EEC).

It is conceivable that the specialised institutions concerned have preferred a narrow definition rather than being subject to a comprehensive scheme of regulation. The regulatory gap has been filled at least for broker firms since the Council has recently adopted a relevant directive relating to security services.\(^{38}\) Those undertakings neither being subject to the Second Directive nor other EC regulation will be governed according to national rules.

\(^{37}\) The controversy is summarized by Zavvos, loc.cit. (note 1), at p. 272.

on the one hand but may benefit from primary EC provisions (Arts. 52, 59, 67).

Where a specialised finance institution is a subsidiary of a credit institution authorised in the EC, it is possible to bring it under the regime of the Second Directive if it fulfils the restrictive requirements laid down in Art. 18 II.

For that reason institutions which are mainly concerned with acquiring holdings or pursue one or several banking activities\textsuperscript{39} will then be enabled to carry out their business as ordinary credit institutions throughout the EC.

Taking into consideration the discussion which institutions should be subject to banking co-ordination, the conclusion may be drawn that the inclusion of a narrow definition has shaped the protective goals for the EC regulation on banking supervision.

Following the traditional approach towards this matter, supervision of banks is chiefly concerned with depositors' and savers' protection by way of emphasising institutional aspects and thereby granting the credit institution's solvency. Hence it is quite important at this stage to focus on the relationship between the narrow scope of application and the regulatory contents of the Directive.

Pursuant to its limited ambition, the Second Directive is confined to classical instruments of financial supervision, albeit supplemented by the novelty that the holding structure has to be made transparent and participation in the industrial sector is restricted.

The delimitation between credit institutions and finance institutions does not refer to what sort of activities are being

\textsuperscript{39} See Art. 1 para. 6 of 89/646/EEC, loc.cit. (note 29), at p. 3.
carried out. Virtually, it makes a distinction between universal banks which regularly meet the cumulative definition and more or less specialised institutions which do not. As the first per definitionem also cover specialised services, they compete with the latter on the same markets under different legal regimes.

Moreover, making a clear delimitation has turned out to become increasingly difficult since finance institutions tend to widen their range of activities. Despite this factual market development, in which a sharp definition referring to passive and active business seems to be somewhat artificial, the directive in its scope of application does exclude financial institutions as defined in Art. 1 no 6.

This might indicate a strong interest of specialised undertakings to retain the status quo, i.e. not to fall under the approximated requirements of banking supervision but carrying out business beyond any state control.40

As the narrow definition indicates the restriction on mere depositors' and savers' protection through granting the institutions' solvency, the Directive already reveals the little extent of harmonisation of banking law in general. Particularly, it does not aim at harmonising the banking activities enumerated on the agreed list annexed to the Directive.

Neither is there any reference to financial techniques nor to contractual matters in the provisions of the Directive, so that the Directive is seemingly not concerned with the functioning of the banking market beyond institutional control. The reasons for this omission are to be found in integration policy. However, it

40 Horn, ZBB 1989, 107, at p. 112; also Steinherr, ZBB 1989, 121, referring to the competitive situation of banking services.
obviously corresponds with the classical approach toward banking supervision, namely to concentrate on prudential control related to banks' solvency.

2. "Agreed List of Banking Activities"

The regulatory concept of opting for a narrow personal scope cannot be assessed without regarding the direct link to the agreed list of activities enumerated in the annex to the Directive. The list comprises all services making up the core of banking activities. However, the annex does not present a final list. In order to react to current developments in the banking sector the list will be updated regularly by a committee to be set up pursuant to Art. 22.

In general, banking activities going beyond the list will be guaranteed under the basic freedoms laid down in primary Community law. Consequently, credit institutions will be able to pursue those activities freely if there is no specific regulation in the host country compatible with EC law.

In all other and presumably the majority of cases banking activities not yet listed will be subject to existing Member State legislation. However, according to the principles already set up by the European Court\(^\text{41}\), the legislation has to be justified by the "general-good test".\(^\text{42}\) Hence, activities not covered by the annex list may face a remarkable legal uncertainty due to the not yet solved problem of interpretation of this principle.


\(^{42}\) See also remarks infra, at III.H.3.
Most importantly, those activities not yet listed will still require a fresh authorisation if a credit institution wants to offer them in another Member State. In conclusion, the list also marks the limitation of the principle of a single banking licence. Where a credit institution is licensed by its home authorities pursuant to the directive's harmonised requirements for a certain range of activities, it is entitled to provide those services throughout the EC. On the contrary, a service not being covered by the home country authorisation may not automatically be offered in the host country.\textsuperscript{43} This is in accordance with the general requirements of cross border banking laid down in Art. 18 I of the Directive. The single license granted by the home country in this respect has a restricting effect where it is generally considered to widen an institution's range of operation.

As to its impact, the agreed list finally will impose pressure on the Member States to approximate still existing differences in legislation: due to the single licence principle, credit institutions will be enabled to enter host markets without the necessity to comply with host country supervisory rules existing there.

It follows that they might offer services which possibly cannot be covered by domestic institutions by virtue of stricter national rules (reverse discrimination) which are not applicable to banks from other Member States any longer under the home country control principle.

Where Member State law still imposes reverse discrimination on domestic competitors, the future will have to show whether the undertakings concerned are still able to retain their market position. In other words, it is open to question whether Member

\textsuperscript{43} Bader, EuZW 1990, 117, at p. 121.
State legislation can be upheld although causing unequal legal treatment. To that extent, the principle of mutual recognition will lead to a competition of different, albeit approximated, supervisory systems and laws.\textsuperscript{44}

However, the list of activities falling under the principle of mutual recognition indicates a deregulatory tendency. In particular, it contains every type of trade with securities (cf. no 7e of the annex). According to the mechanism explained above, credit institutions henceforth will be able to carry out this business provided that their home country authorisation covers trade on securities.

The single licence will be effective even in countries where commercial banking and security trade are traditionally separated.\textsuperscript{45} Banks from other Member States may deal with securities without being associated to the stock exchange. Established monopolies as a consequence are supposed to be eroded.

Either the stock exchange has to be opened for credit institutions or securities will have to be marketable outside of it. It is hardly conceivable that due to this sharp incision on the finance market the Member States concerned will uphold their strict restrictions for domestic institutions.

This example reveals the deregulatory effects of the Second Directive by enhancing the competition between legal orders and not harmonizing directly through express provisions.

\textsuperscript{44} Schneider/Troberg, WM 1990, 165, at p. 166; for a thorough analysis as regards the competition of legal orders see Reich, CMLRev 29 [1992] 869 et seq.

\textsuperscript{45} France, Italy, Greece, Belgium, Spain.
The Member States will as a result have to re-examine their national provisions as regards competitive disadvantages caused by stricter national rules compared to EC harmonisation.

It is, however, conceivable that certain national provisions being stricter than the harmonised standards do not effect the institutions' competitive situation. Stricter supervisory rules can also lead to more confidence of the consumer and as a result enhance the institution's market position. Consequently domestic and foreign banks possibly will operate under different schemes of regulation. It is therefore justified to speak of a competition between legal orders.46

Apart from the factual development of cross border activities, the example of security trade shows that the Second Directive will cause essential changes for the structure of national banking markets. Universal banks will be able to compete with specialised institutions much more intensely than under the former regime of numerous restrictions. This will certainly be true for the international perspective but also - if not primarily - for the situation amongst national competitors.

As far as credit institutions are enabled to provide services listed in the annex throughout the Community, the question arises to what degree mutuality is extended to the recognition of laws defining the character of services as such. Following the Directive's contents, it is exclusively dealing with banking supervisory law whereas aspects regarding the supervision of services as such have been left aside. Nevertheless, the activities

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46 Cf. Reich, loc.cit. (note 44).

3. "Branch"

Possible ways of establishment for companies as listed in Art. 52 refer to principal places (head office) as well as to secondary places of business (agencies, branches, subsidiaries).

However, the directive does not differentiate likewise but refers to branches in the sense of "place of business" (Art. 1 no 3) whereas the provision of Art. 52 furthermore contains agencies and subsidiaries. The latter form might be treated equally to credit institutions if it complies with the "financial institution"-definition (Art. 1 no 6; Art. 18) but is not regarded as an admissible alternative of establishment.

Apart from Art. 59, a credit institution may thus benefit from the easements under Art. 52 only in cases where it supplies its services in other Member States through legally dependent branches while independent subsidiaries will have to be regarded as domestic institutions. They are therefore not recognised as a cross border establishment within the meaning of Art. 19 of the Directive. Credit institutions making use of Art. 52 by establishing subsidiaries in other Member States will, as a result, not benefit from the principle of home country control.\footnote{See van Gerven, 10 YEL [1990] 57, at p. 61.}

In addition, the Directive does not respond to a situation where the basic freedom of Art. 52 is relevant although the institution's
activity is not carried out by a branch. According to the "permanent presence"-doctrine, Art. 52 applies to any operation which is entirely or principally directed to a host country without having a local presence there.

The meaning of establishment developed pursuant to the derogations of Art. 59 is remarkably wider than the definition of "branch" pursuant to Art. 1 no 3.

This allows for the conclusion that a "permanent presence" is not subject to the Second Directive at all.

This view is enhanced by the 8th Recital of 89/646/EEC stating that the Member States shall refuse authorisation where "a credit institution has opted for the legal system of one Member State for the purpose of evading stricter standards in force in another Member State in which it intends to carry on ...the greater part of its activities."

In order to prevent any abuse of the home country principle, the "...institution shall be deemed to be situated in the Member State in which it has its registered office; ...the Member States must require that the head office (is) situated in the same Member State as the registered office."

As a result, the Directive apparently just wants to avoid a situation in which an institution's organisational basis falls apart from its virtual operational basis where it is permanently present.

Notwithstanding the Directive's wording, the confinement on branches in Art. 1 no. 3 is not persuasive as the "permanent

presence-situation" does not necessarily indicate an abusive behaviour. In so far, the Directive has seemingly not yet reflected the results of the European Court case law. Moreover, the permanent presence will not be governed by Art. 59 of the Treaty and thus Art. 20 of Directive 89/646/EEC, as the relevant judgments in this respect aimed to exclude Art. 59 under these circumstances.

According to the Directive's explicit wording, however, it can be concluded that the "permanent presence" does not fall under its scope but is governed directly by primary EC law.50

D. Competent Authorities

There will be no central authority for the supervision of credit institutions in the EC. On the contrary, the control of banking business will be carried out by national authorities. For certain issues the Directive additionally provides for cooperative solutions, including the Member States' authorities as well as the Commission (cf. Art. 21 Para 7, Art. 22).

The most important innovation introduced by the Second Directive is an EC-wide control of a credit institution by its home country authority. At an earlier stage of integration the principle of home country control partly was applied to subsidiaries subject to consolidated supervision (Art. 3 III of Directive 83/350/EEC).51

In principle, the extent of home country control consequently covers an institution's activities throughout the Community, be it

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51 O.J. 1983 L 193/18, 19.
in its country of primary establishment where the head office is situated or be it in other Member States.

Supervisory competences thereby also include the control of ongoing business independently from the legal form chosen for the supply of services.

As a result, the competences of national authorities have considerably extended as they will cover not only the domestic activities of credit institutions but also their business in other Member States. On the other hand supervisory competences of the host country towards institutions from from other Member States consequently have been reduced.

Summarizing the situation under the Second Directive, the banking supervision is still organized nationally on the basis of coordinated conditions for authorisation and ongoing control.

Art. 18 I enshrines the principle of a single licence in so far as it requires Member States to recognize that the competent authorities of the home Member State shall be responsible for the prudential supervision of credit institutions, excluding however the supervision of matters which by virtue of the Directive lie within the responsibility of the authorities of the host Member State, particularly the liquidity of branches and measures to implement monetary policy (Art. 14 II).

Apparently, Art. 18 I in the first place gives credit institutions the benefit of mutual recognition in two specific spheres: authorisation and prudential supervision. In these two spheres there will be no duplication any longer. The scope of mutual recognition in this respect is determined by the legal form chosen for carrying on banking activities.
E. **Harmonised Requirements of Authorisation**

Basically, the taking up of banking business requires an authorisation. For that reason an undertaking has to comply with certain conditions. According to the single licence principle, no distinction will be made any longer as to where a credit institution proposes to be active in one or several Member States.

According to the concept of integration chosen for the completion of the internal market, harmonised rules for authorisation laid down in the banking directives only have created minimum standards allowing the Member States to opt for stricter rules.

However, the latter will only apply to domestic institutions and not to foreign ones who will be governed exclusively by the law of their home country. The concept of integration therefore gives rise to reverse discrimination. Stricter national rules in particular are admissible in respect of authorisation, Art. 4 (initial capital), Art. 5 (identification of major shareholders), as well as ongoing control, Art. 11 (ongoing control of shareholders), Art. 12 (industrial shareholdings) and 16 (professional secrecy).\(^{52}\)

1. **Own Funds**

According to Art. 3 II of the 77/780/EEC, the credit institution has to possess legally independent own funds legally defined by

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\(^{52}\) See Recital No. 9 of the 2nd Banking Directive, loc.cit. (note 29), at p. 2.
Art. 2 of the own funds Directive. In order to exclude single private bankers held personally and unlimited liable, the institution itself must have the entire and unrestricted control about the minimum funds.

The minimum of own funds derives from the required initial capital of 5 Mio. ECU (Art. 4 I) which has to be upheld during the whole period of ongoing business, Art. 10.

The legal definition of own funds is laid down in a specific directive on own funds. Albeit not discussed here in depth, this supplementary act forms a key issue in banking supervisory law as it is set out to make the financial situation of a credit institution more transparent.

The Second Directive in this regard also applies the White Paper approach of mutual recognition: credit institutions, authorised according to harmonised rules and being endowed with elements of own funds as required for in the Directive (Art. 4), henceforth will be able to operate in other Member States, although the host State might apply different and likely more restrictive concepts in defining own funds.

Another important measure in respect of financial control at EC level to be named here is the Directive on a solvency margin of credit institutions. This technical term of prudential control


expresses the proportion between the bank's own funds and its business volume. It allows for a standard to assess as to what extent calculated own funds are sufficient to cover the risks emerging from the volume of business.57

2. Initial Capital

As already mentioned, the initial capital for the taking up of business is about 5 Mio. ECU. Art. 4 II allows for exceptional permissions to reduce that amount on a reasoned request. The initial capital has to be distinguished from the own funds as it only makes up a part of the institution's own funds admissible under Directive 89/299/EEC.58 The initial capital as a consequence must be calculated on the basis of some components of basic own funds.59

3. Managerial Requirements

The minimum number and qualification of the institution's managers was already laid down in Art. 3 II of the First Directive. At least two persons virtually have to run the institution's business (four-eye-principle). In addition, the directors have to be of adequate experience and reliability to carry out their functions.

57 See Hellenthal, loc.cit. (note 12), p. 107 with further references.
58 See Art. 1 No 11 of the Second Banking Directive in connection with Art. 2 I Nos 1/2 of the Own Funds Directive.
59 For an example see Hellenthal, loc.cit. (note 12), p. 63.
4. Operation Scheme

The institution has to lay down the kind of proposed commitments and the administrative structure of the undertaking in an operation scheme to be submitted along with the request for authorisation, Art. 3 IV of Directive 77/780/EEC.

5. Transparency of Major Shareholders

The extent of institutional control before an authorisation will be granted is indicated by the introduction of a compulsory disclosure to identify the name and amount of major shareholders (Art. 5 I).

Compulsory notification has to be made about the identity of shareholders and their amount of participation if the shareholdings represent at least 10% of the capital, voting rights or other significant influence on the undertaking (Art. 1 no. 10).

No distinction will be made whether the shareholder is a natural or legal person. Where the structure of such a holding does not comply with the essential needs of a sound and prudent management, the competent authorities will dismiss a request for authorisation.

The competent authority may refuse granting the authorisation if the shareholders concerned give rise to any doubt related to the sound and prudent management of the institution, Art. 5 II.

The sanctionable character of the disclosure requirement thus may be considered as a control over the concentration of business
in the field of banking. Having obtained the relevant information beforehand, the competent authorities are enabled to take protective measures against risks caused by the often not transparent structure of international holdings.

The Directive as a consequence particularly refers to the situation where a credit institution is part of a conglomerate of banks, finance companies or even general trading corporations. The undertaking is possibly facing risks emerging not specifically from its own banking activities but from the involvement in a conglomerate structure.

Already before commencing its activities the credit institution has to ensure, by way of disclosure, a holding structure suitable to the financial standing especially needed in the sensible field of banking. Meanwhile, it has been doubted whether this far-going control complies with the property rights of the persons concerned.

F. Conditions Related to Cross Border Activities

Arts. 19, 20 and 21 of the Directive give effect to the principle of mutual recognition provided for in Art. 18.

60 Emmerich, WM 1990, 1, at p. 4.
61 See in so far the rejection of the Bundesrat of 14.10.1988, ZIP 1988, A 159 Nr. 559; see Schneider, BB 1989, 84 et seq. contrasting the Directive’s provisions with German law.
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1. Branching

The definition of a branch is given in Art. 1 no. 3. Three possible constellations can be distinguished:

- branching in a foreign Member State;
- branching in the home Member State;
- branching by credit institutions having their head-office outside the EC.

The latter one will not be dealt with in this paper, since the aspects of third country relations are entirely left out here.

2. Branching in the Host Member State

Host Member States may no longer require authorisation for branches of credit institutions already licensed in another Member State (Art. 6 I). Accordingly, every service listed in the Directive's annex can also be carried out through branches in other Member States without fresh authorisation by the host country.

The former obligation pursuant to Art. 4 I of the first Directive therefore had to be eliminated provided that the branch is established by a credit institution which has been authorised and is supervised in the home country (Art. 18 I). The authorisation has to cover all services which are proposed to be offered by the branch in the host country.

The single license, however, is not valid in respect of subsidiaries although in the cross border business establishing subsidiaries is more widespread than branching. While forming a

62 Supra at III.C.3.
legally independent unit of a holding company subsidiaries have to ask for fresh authorisation in the host Member State if they propose to pursue business there.

The significance of the single licence principle in this context arises from Art. 8 III of 77/780/EEC allowing for the requirement of fresh authorisation related to branches from other Member States according to the host country's economical needs. The refusal of authorisation to pursue business in other Member States under the First Directive was executed by the competent authorities of that country. The decision could be based not only on grounds enumerated in the Directive but also on other restrictions in the host country.

This possibility is eliminated by the Second Directive by way of introducing the principle of home country control. One of the essential impacts on the host countries responsibilities therefore is the radical reduction of market control and policy as long as it is not based on liquidity or monetary aspects (Art. 14 II).

In order to prevent a foreign credit institution from pursuing business, the host country control is confined to its means based on the general good rule in emergency cases provided for in Art. 21 V of the Second Directive.

The single licence principle is set out to allow credit institutions to spread a network of branches throughout the Community. The mere requirement of compulsory notification seems to contribute to the easing of cross border establishment, which is normally linked to time-consuming and costly procedures, due to the formerly

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63 Art. 8 I of 77/780/EEC, loc.cit. (note 15)
64 Art. 8 I e of 77/780/EEC.
required endowment capital\textsuperscript{65} and building a separate part of the institution's own funds (Art. 6 I).

According to the idea of the internal market, the legal and procedural requirements for the establishment of branches in the EC should be comparable to domestic branching.

However, the formalities have not been totally omitted. A remarkable amount of information has to be submitted to the home country authority (Art. 19 II) which will communicate the proposed establishment to the host country within three months (Art. 19 I, III).

Within two months of the receipt, the host state authorities are obliged under Art. 19 IV to prepare for the supervision of the credit institution in accordance with Art. 21.

They shall, if necessary, indicate the conditions on which, in the interest of the general good, those activities must be carried on in the host Member State.

The institution may establish the branch and commence activities pursuant to the time-table set up in Art. 19 V. As the beginning of the two months period in Art. 19 IV is not fixed, it is conceivable for an institution to wait until the expiry of five months from the initial notification to the home country authorities.\textsuperscript{66} This needless legal uncertainty should be withdrawn in the process of implementation through the Member States.

Although the notification procedure is formally not equivalent to the conditions of authorisation, it is in fact fairly similar to that procedure. In the first place, the home country authorities are

\textsuperscript{65} Art. 4 I of 77/780/EEC.

enabled to prevent the cross border establishment when they refuse to communicate the received information to the host country (Art. 19 III 3). The refusal can be based on unsuitable administrative structures and the financial situation of the institution concerned (Art. 19 III 1).

For that reason, the authority sets up an inquiry according to criteria already used for the authorisation. Another similarity to formal authorisation stems from the opportunity to ask review by the courts in the event of refusal (Art. 19 III 3).

3. *Branching in the Home Member State*

The freedom to establish cannot be interfered with by the host country any longer but is still subject to a possibly restrictive home country policy. The withdrawal of the fresh-authorization requirement thus does not necessarily mean that branching in other Member States will be easier than under the First Directive.

As a result, the institution's basic right to establish and to enter other markets in the Community is still not accompanied by a right to leave the market of origin.67

In the event that the procedure of the home country authority according to Art. 19 is carried out under stricter rules than a fresh authorisation in the host country, the institution might evade such a situation by establishing a legally independent subsidiary.

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67 Bader, EuZW 1990, 117, at p. 120.
4. Providing Services

In order to provide services for the first time in another Member State without opening a branch there, a credit institution will simply have to notify the competent authorities in its home country of the activities intended to pursue in the host country (Art. 20 I). The latter is informed by the home authority within one month after having obtained the institution's notification. Again, it is not explicitly stated in the Directive when the institution may commence its activities. According to the wording and following a liberal interpretation it is admissible to state that the institution is allowed to do so as soon as the notification has been made.

5. Overlap between Art. 52 and 59 EEC Treaty

The procedure of notification is also important for credit institutions wishing to operate through a branch and by providing services at the same time within the territory of the same Member State.

In its insurance cases the European Court has created a rule against overlapping. This does not necessarily mean that the same institution could not carry on certain operations through branches and others through the provision of services.

The rule applies when an undertaking, with regard to the same activity, at one time does rely on the application of rules relating to branches and at another time does escape the application to those rules by presenting its activities as being carried on by way of providing services.
This risk does not occur as long as both types of activity are clearly delimited since there is no possible overlap concerning the rules applicable to each of these activities. The institution therefore should declare at the outset whether the activities are to be carried on either by way of providing services or through branches. 68

The Second Directive apparently does not contain any provision governing these issues. However, Art. 4 IV of 77/780/EEC gives an optional right to the Member States to set up own conditions for separated authorisation going beyond the compulsory notification. Again, the issue of reverse discrimination arises.

G. Ongoing Control

I. Possible Activities in the Host Country

The Second Directive does not refer to activities which an institution possibly could carry out in its home Member State. It is thus left to the Member State to what extent the authorisation granted is valid in its own territory.

As far as cross border activities are concerned, the Directive however introduces a catalogue of activities being subject to the principle of mutual recognition. The activities listed in the Directive's annex can be pursued without fresh authorisation. A restriction in so far follows from Art. 18 I (at the end) saying that the activities concerned must be covered by the home Member State authorisation.

68 See van Gerven, 10 YEL [1990] 57, 63 f.
2. **Minimum Amount of Own Funds**

The initial capital necessary for authorisation, normally about 5 Mio. ECU, has to be upheld during the whole period of business, Art. 10 I. The increased level has been highly criticised particularly by smaller institutions being confronted with a striking threshold to market presence. As a result, the Directive provides for transitional or exceptional clauses.

Community regulation in so far will influence the concentration of banking business and thus the market structure, as smaller competitors have difficulties to stay independent. However, it is left to the Member States to what extent they make use of requiring lower amounts.

3. **Activities in the Industrial Sector**

Industrial shareholdings by credit institutions demand for adequate control in order to grant their financial stability. It is obvious that any economic crisis of non-bank subsidiaries will likely influence the health of banks (contagion risk). Moreover, any shareholding tends to bound remarkable assets which are consequently missing in the banking sector.

In spite of existing Member State legislation, harmonisation was deemed to be necessary. According to Art. 12 an institution's participation in a non-bank undertaking is restricted to a percentage of 15%. The total amount of qualified holdings may not exceed 60% of the own funds.
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Any industrial holding has to become subject to consolidated banking supervision provided for in Directive 83/350/EEC. With regard to the rapid development of all-finance-conglomerates it is remarkable that the restriction is not extended to shareholdings related to insurance companies.

H. Enforcement Rules

I. Assignment of Competences

Art. 21 governs the exercise of residual powers by the host country with regard to institutions coming from other Member States. On that behalf, one has to distinguish two categories of enforcement competences. The first is based on responsibilities directly arising from provisions pursuant to the Directive, e.g. particular powers according to Art. 14 II (liquidity; monetary policy).

The various procedures laid down basically foresee that the host country authority will have to notify every infringement of provisions subject to its competences, but the authorities of the institution's home country have to take the necessary measures to bring such infringement to an end. Only in urgent cases or where the measures taken by the home Member State are inadequate, the host country will be competent to enforce the termination of irregularities.

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The second category covers the powers of the host Member States to prevent or to punish a behaviour which is contrary to the legal rules they have adopted in the interest of the general good.

2. **The Concept of the General Good**

The principle of general good is not only mentioned in Art. 19 IV and Art. 21 V, but also in Art. 21 XI where it restricts the credit institutions' right to advertise their services in other Member States.\(^70\)

The regulatory concept chosen for the assignment of competences to the host country, in opposition to the general rule of home country control, gives rise to the question of how to cope with the emerging legal uncertainty of the concept of general good.

All activities mutually recognised can be carried out in compliance with host country provisions adopted in the interest of the general good.\(^71\) This restriction in the future will make up a basis of remaining host country control.\(^72\) The "general-good-test" has been taken over from the free-movement-of-goods sector (Art. 30 EEC Treaty) following the "Cassis de Dijon"-Doctrine of the European Court.\(^73\)

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70 An exceptional provision as the Second Directive generally refers to institutional control.


72 Bader, loc.cit. (note 54), at p. 84.

73 Troberg, loc.cit.(note 13), at p. 43; Case 120/78, loc.cit. (note 22).
The general-good-approach has been applied to financial services for the first time in the insurance judgment of 4.12.1986. The reference to provisions protecting the general good is possible where the following conditions are fulfilled:

- the provisions have to be applied without discrimination to foreign banks;
- they have to protect the general good of the host Member State;
- the interest protected is not or not sufficiently considered by the institution's home country regulations;
- the provisions comply with the principle of proportionality.

It is commonly accepted that provisions protecting vulnerable consumer interests are elements of the general good feasible to restrict the freedoms of Arts. 52, 59 in accordance to the European Court case law. The discussion henceforth will concentrate on the question whether consumer protection is already subject to harmonised Community law, covered by home country provisions and is proportional with regard to the vulnerable interests concerned.

In particular, one has to examine to what extent the host country may require credit institutions to comply with relevant provisions of its own legislation in areas which are not or will not be harmonised at Community level.

A first hint given by the Directive can be found in its recitals setting out the way in which credit institutions already authorized

74 Case 205/84, loc.cit. (note 41).

75 Recital No 16, loc.cit. (note 29), at p. 2; the wording has been modified in the course of legislative process: originally, the host countries were obliged to ensure that the activities could be pursued by "using the financial techniques of the home Member State".

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in their home country must be enabled to carry on activities benefiting from mutual recognition in the host country.

The following remarks will not deal with the interpretation of the "no obstacles" clause in the sense of the Directive's recital but will rather present its commonly accepted frame of interpretation.

This will be done according to the European Court case law since the terminology used here refers to the conditions recognized by the European Court for the justification of national rules forming an obstacle to the free movement of goods or services.76

National rules impeding intra-Community trade may be applied to nationals from other Member States solely in areas which have not yet been harmonised within the Community. Otherwise, it is no longer open to the Member States to lay down derogations unless secondary Community law explicitly authorize them to do so.

In the absence of harmonisation, Member States are prohibited from retaining rules which, directly or indirectly, lead to overt or disguised discrimination between Community nationals for reasons of nationality.77

Non-discriminatory rules are not allowed if not justified by grounds listed in Art. 36 of the Treaty or where they satisfy one of the requirements recognized as being mandatory according to Art. 30, e.g. consumer protection.

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76 See van Gerven, loc.cit. (note 48) with references.

Moreover, equivalent regulations compared to those already existing in the home country would produce unnecessary duplication and are therefore contrary to the basic freedoms.\textsuperscript{78}

Finally, no national regulation may be disproportionate to the aim in view and to the result actually achieved by the measure. Member States as a consequence will have to adopt the least restricting measure if feasible to achieve the same results than stricter provisions.

In practice, it does not seem to be always easy to identify those provisions protecting the general good. The Second Directive, however, imposes the burden of identification of the general good on the host countries (Art. 19 IV).

For that reason it is to question whether the host country authority may take measures based on the competences given in Art. 21 V in the event that the infringed regulation has not been notified in the procedure laid down in Art. 19.\textsuperscript{79}

An institution adequately informed about the legal environment in the host country will apparently rather comply with national legislation. Otherwise, where the burden of information lies with the institution, the probability of non-compliance is more likely.

In conclusion, Art. 19 IV is of no preclusive effect but assigns the burden of information taking into account that the knowledge about the host country's legislation is distributed more effectively.


\textsuperscript{79} See van Gerven, loc.cit. (note 48), at p. 69.
3. **The Concept of General Good as Applied in the German KWG**

Germany has recently implemented the Second Banking and Supplementary Directives by re-enacting the banking code (KWG) which is solely concerned with institutional control.\(^80\) For the purpose of this paper it is useful to mention this implementing work here in respect of German rules in the KWG intended to protect the general good, albeit the very specific provisions cannot be analysed here thoroughly.

The notification procedure according to which the host country authority has to indicate the conditions under which, in the interest of the general good, those activities must be carried on in that state (Art. 19 IV of the Second Directive) has been implemented in Germany as follows (KWG sec. 53 b):

"Das Bundesaufsichtsamt hat.(..).die Bedingungen anzugeben, die nach Absatz 3 für die Ausübung der von der Zweigstelle geplanten Tätigkeiten aus Gründen des Allgemeininteresses gelten.(..)".

The provision thereby confirms that the German Supervising Authority (BAA) will, pursuant to the home country control principle, henceforth participate only to a little extent in the procedure of market authorisation of foreign branches.

However, in order to prepare that remaining control, the BAA has to inform the credit institution about the legal conditions still applicable to its German branches.

Responsibilities and executive competences of the German Supervising Authorities therefore are laid down in KWG sec. 53 b III:

"Auf Zweigstellen .(..) sind die §§ 3, 11, 14, 18 bis 20, 23, 23 a, 24 I Nr. 6 bis 9, §§ 25, 30, 37, 39 bis 42, 43 II, III, § 44 I Nr. 1, II bis IV, § 44 a I, II sowie die §§ 46 bis 50 mit der Maßgabe entsprechend anzuwenden, daß eine oder mehrere Zweigstellen desselben Unternehmens als ein Kreditinstitut gelten.

Für die Erbringung von Dienstleistungen ..(..) gelten die §§ 3, 23 a und 37 entsprechend."

The draftsmen-report in this respect reveals that KWG sec. 53 b III 1 KWG includes all German provisions, still applicable to branches coming from other Member States.

The set of quoted provisions thus is understood to cover non-harmonised matters as well as provisions protecting the general good.

The BAA accordingly retained the responsibility for the control of the foreign branches liquidity (KWG sec.11)\(^81\) as well as it may supervise and enforce the compliance with the provisions protecting the general good.

The German authorities' right to "on-the-spot-verifications" (KWG sec. 44 I No. 1, III, IV; 44 a I, II)\(^82\) is supplemented by the branch' obligation to disclose statistical information if


\(^{82}\) In implementation of Art. 15 III of 89/646/EEC.
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requested (KWG sec. 25). Adequate measures to enforce host country control are provided for in KWG sec. 3, 37, 46 to 50.

The latter set of provisions seemingly can be identified as provisions protecting the general-good: they impose emergency competences to the BAA where a credit institution carries on prohibited services (KWG sec. 3) or has become insolvent or is even on the brink of bankruptcy. The same is true for KWG sec. 23 according to which the BAA is enabled to prohibit certain types of commercial advertising.

Finally, the catalogue of KWG sec. 53 b III contains the provision of sec. 23 a obliging branches to inform there clients if it is not member to a German Deposit Guarantee Scheme. This provision as well as the enforcement rules are also applicable to the direct provision of services from other Member States (KWG sec. 53 b III 2).

IV. Functional Regulation

A. General Remarks

The legal framework for banking operations cannot be circumscribed entirely by institutional requirements as presented above. Institutional coordination is chiefly concerned with provisions enabling credit institutions to have access to markets in other Member States according to harmonised and therefore

83 Art. 21 I of 89/646/EEC.
84 Art. 21 VIII of 89/646/EEC.
common principles of supervision mainly based on administrative law.

Contrary to rules related to institutional control, so-called functional regulation\(^\text{85}\) has to cover a wider range of coordination as it is not confined to deregulate the mere access to foreign EC markets. It moreover combines the question of market access with more wide-reaching issues of the institution's market conduct as well as its contractual relationship to other banks and notably to customers.

However, the extent of coordination in this area of law does not keep pace with the far-reaching EC harmonisation concerning the financial supervision of credit institutions. In the absence of positive harmonisation it is thus necessary to examine the extent of mutual recognition in this area of law.

The following will focus on issues of harmonisation related to contractual relations and therefore to regulatory measures at EC level influencing the private law of the Member States, albeit keeping in mind that functional regulation can also derive from administrative law.

**B. Banking Contract Law**

As regards to financial services, contract law does not only define the parties' general obligations related to the performance of a commitment. It is moreover the peculiarity of financial services being "invisible products" that makes them obtain their

\(^{85}\) For a terminological delimitation see Schneider/Troberg, WM 1990, 165 et seq.; Troberg, WM 1991, 1745.
character by legal rules and definitions, laid down usually in pre-drafted standard terms of banks.

The autonomy to define contractual commitments is restricted by different mandatory provisions of private or, in some Member States, even administrative law. Since standards differ according to the economic, political or legal traditions of each country they also provoke impediments to cross border services and consequently challenge the concept of mutual recognition.

There will be no free circulation of financial services as long as contract law is entirely left to the traditional rule saying that the supplier has to adapt the product to the mandatory provisions of the host country.

To give an example, a long-term credit admissible in the country of origin with variable interest rates cannot be offered in other Member States where credit is limited to specific interest rates or by imposing at least certain limits.

In order to comply with the requirements of the host country, the lender will not only have to adapt the contract terms but has in addition to reorganise the finance techniques, thereby fixing a new price for the products.

As a result, the competition of financial services crossing borders would be distorted since it is charged with unjustified transaction costs in a prospective single market where borders should not - any longer - contribute to increase the prices.

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86 Taken from Schneider/Troberg, WM 1990, 165, at p. 168.
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1. Subject to Primary Community Law

Art. 100a EEC Treaty contains a general Community competence for the harmonisation of national laws and regulations which exercise, actually or potentially, directly or indirectly, an effect on intra-Community trade. Art. 100a thus constitutes a complement to the well-known Dassonville-formula.\textsuperscript{87}

Applied to the coordination of private banking law it is therefore decisive whether the single banking market requires uniform rules.

However, the application of Art. 100a concerning the approximation of private law has not yet caused any problems since the EC institutions have practically almost free hand in interpreting this provision\textsuperscript{88}, and did thus adopt it in various fields of private law.\textsuperscript{89}

2. Subject to the Second Banking Directive

The Second Banking Directive does not contain explicit provisions extending the mutual recognition principle to legal institutions based on civil law. Discussion concerning an extension

\textsuperscript{87} Case 8/74, - Dassonville - [1974] ECR 837.

\textsuperscript{88} Reich, EuZW 1991, 203, at p. 207; Barents, 30 CMLRev [1993] 85, 106.

\textsuperscript{89} Overviews were given by Hauschka, NJW 1989, 3048; Schneider, NJW 1991, 1985; Müller-Graff, NJW 1993, 13.
to contract law\textsuperscript{90}, however, has been based particularly upon Art. 18 I of the Directive:

"The Member States shall provide that the activities listed in the Annex may be carried on within their territories, in accordance with Arts. 19 to 21, either by the establishment of a branch or by way of the provision of services, by any credit institution.(..), provided that such activities are covered by the authorisation."

Whereas the wording guarantees banking activities only in general, it follows from the relevant recital that activities have to be authorised without restrictions and under the same conditions as in the home Member State:

"...the Member States must ensure that there are no obstacles to carrying on activities receiving mutual recognition in the same manner as in the home Member State, as long as the latter do not conflict with legal provisions protecting the general good in the host Member State"\textsuperscript{91}

The question arises whether Art. 18 thus allows for a comprehensive liberalisation of banking activities which also includes matters of contract law.

Having regard to the term "restriction", there is no distinction between institutional or functional control. In the first place this could be justified by the close connection of banking services to civil law since the latter is governing the terms by which financial services are normally defined.

\textsuperscript{90} Wolf, WM 1990, 1941.

In particular, the interpretation of "restriction" has to consider its relation to Art. 52, 59 EEC Treaty which the Directive essentially wants to implement.

Where banking services from one Member State cannot be offered freely in the host country since its contractual terms are not recognised or submitted to mandatory provisions, the principle of free market entry could become worthless.

Any Member State regulation related to the provision of services based on civil law thus might cause equivalent effects as the supervisory rules being imposed on institutions as such. 92

In order to criticize this view, one firstly has to qualify it in respect of the freedom of establishment. It would be no unjustified restriction on foreign branches to offer their services in accordance with the laws of the host country since they are supposed to carry out their activities for a certain period of time under a foreign jurisdiction.

Moreover it is rather doubtful that the issue of mutual recognition of financial services in respect of contract law has already been solved by the Second Banking Directive. 93 Possible connotations of the Directive’s wording according to Art. 18 I have to be contrasted with the Commissions view regarding specific harmonisation of certain financial services:

"...the harmonisation of certain financial and investment services will be effected, where the need exists, by specific Community instruments, with the intention, in particular, of protecting consumers and

92 Wolf, loc.cit.(note 90), at p. 1944, contrary to Steindorff, 150 ZHR [1986], 687, 698.

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investors; …the Commission has proposed measures for the harmonisation of mortgage credit in order, inter alia, to allow mutual recognition of the financial techniques peculiar to that sphere;…"

This statement allows to deny the presumption that the Second Directive aims at the mutual recognition of banking services in terms of their contract law implications.

Following the recital it can rather be said that the impact of existing directives and private international law supposedly will have to be evaluated first and that the necessary measures will be taken afterwards. Practice therefore will have to show the effectiveness of present legislation primarily set up to open markets for institutions.

In the absence of harmonisation, the principle of mutual recognition does not apply to the banking service as such and therefore any commitment might find its limits in the host country's mandatory provisions.

This concept is confirmed by the existence of Community choice of law rules laid down in secondary Community law and, notably for banking contracts, in the Rome Convention 1980.

Where the different mandatory provisions of the Member States with regard to Art. 59 cannot be balanced by choice of law clauses, they have to be justified according to the "general good rule". The latter concept, however, still allows for different standards, e.g. in the field of consumer protection.

It is hardly predictable whether a mandatory rule under the current interpretation will be accepted before the European Court as being "proportional" or not. It is therefore the EC legislator who can eliminate the general good defence by introducing
protective measures that coordinate the different standards of contract law.\textsuperscript{94}

Any harmonisation of contract law having an impact on the financial product as such will have to consider that it is the declared objective of EC policy to prevent any standardisation and to rather emerge the offer of a widespread range of services.

3. \textit{Directives on Consumer Credit}

As to harmonised standards for the information and the protection of investors, depositors or generally consumers, the Commission so far has initiated legislative measures only in selected areas of financial services contract law. Secondary Community law thus has been introduced where grievances have been recognised, e.g. by relevant programs set up for the promotion of consumer protection at EC-level.\textsuperscript{95}

The Council Directive for the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit of 22.12.1986\textsuperscript{96} harmonises legal relations between creditors and consumers. This Directive has been amended by the Directive of 22.02.1990\textsuperscript{97}, introducing a uniform method for the calculation of the Annual Percentage Rate.

\textsuperscript{94} van Gerven, loc.cit. (note 48).
\textsuperscript{95} Niehoff, FLF 1990, 278.
This follow-up to the 1987 directive has become necessary since back in 1986 the Member States did not achieve an agreement as to that matter.\textsuperscript{98} However, it was the Commission's declared goal to implement consumer protection and in this respect a uniform calculation method at EC-level was considered to allow for a real comparability of credits available in the EC and to promote the widening of consumers' choice.\textsuperscript{99}

The compromise achieved in 1988 provides for total harmonisation as to the calculation of credit costs and has to be implemented by all Member States after a period of transition (deadline 31.12.1995) in those Member States which have already established other methods before 1986 (Art. 1 II of Directive 90/88 inserting Art. 1a V into Directive 87/102).

Nevertheless, it can be doubted whether the method adopted in Directive 90/88/EEC, the so-called Rule 308 which is internationally used for the calculation of security yields, is eligible to enhance the transparency of credit costs.

The general objective of both directives is to contribute to a uniform European credit market for consumers, open to free competition amongst creditors. As to what extent the directives which had to - apart from transitional periods - be implemented by 1.1.1990 resp. 31.12.1992 have virtually promoted such a process remains to be seen.


The Directive 87/102/EEC on Consumer Credit focuses on the following:

personal and material scope of application (Arts. 1, 2);
adequate information of the consumer related to the conditions and the costs of credit as well as the consumer's obligation (Arts. 3 - 6 and annex to Art. 4 III);
the prohibition of a number of abusive clauses (Arts. 7 - 10);
specific provisions for credit agreements linked with the purchase of goods or the supply of services (Art. 11);
suitable measures for authorisation and supervision of creditors including the establishment of bodies, responsible for complaint handling.

The Directive 87/102/EEC contains minimum provisions (Art. 15), allowing the Member States to impose stricter rules for the protection of consumers. This far-reaching optional right for the Member States nowadays should be contrasted with the implementation of banking liberalisation, namely the principles of home country control and mutual recognition. It has to be examined as to how far stricter rules than laid down in the Directive on consumer credit function as a means to prevent credit institutions from entering markets in the Community.

Accordingly, it has been said, that the consumer credit directives have already defined the vulnerable interests to be protected in all Member States so comprehensively that any stricter legislation would be an unjustified restriction in terms of duplication.\textsuperscript{100} However, this view can be opposed in so far as the

\textsuperscript{100} Emmerich, in: von Westphalen, loc.cit.(note 98), at No. 20.
directives on consumer credit are not deemed to implement the principle of home country control. The minimum standards achieved by the directives on consumer credit can thus not be considered a comprehensive basis for the mutual recognition of credit terms. On the contrary, they have only introduced a minimum set of harmonised rules for credit contracts based on the concept of consumer information. Where a contract complies with the directives' standards it should be valid in all Member States without further restrictions through national legislation. This does not necessarily mean that those contracts may not be subject to further national regulation as regards matters not yet covered by EC harmonisation.\textsuperscript{101}

C. \textit{Harmonised Rules of Conflict}

Banking services as legal products are determined by contractual law pre-drafted through standard terms and supplemented or replaced by non-mandatory as well as mandatory provisions of substantive law.

While comprehensive harmonisation of banking contract law is not in sight, the consumer will - under the condition of open markets in the future - face an increase of risks where he has agreed to choose a foreign and hence presumably unknown law.

Either the familiar protection afforded to him in his country of habitual residence is not equally guaranteed by the law chosen or, due to ignorance and language problems, cannot be enforced likewise.

\textsuperscript{101} Reich, Europäisches Verbraucherschutzrecht (1993), Nos. 160 f.
Apart from impartiality of protection the consumer's interest in derogating from his domestic law has to be regarded. While possibly enabling consumers to ask for services cheaper than under the law of his country or even granting a higher level of protection, it might be more advantageous for them to choose a foreign contractual law.

Which national contract law is applicable to govern banking services in general depends on the private autonomy of the parties regulated by conflict of law rules in the Member States.

Having regard to the above-mentioned interests of the consumer it is necessary to examine to what extent his position in the internal market is recognized in private international law related to banking contracts.

The implementation of Treaty freedoms demands that existing private international law in the Member States has to be removed where it restricts the free movement of services in the internal market.

Art. 59 does not differentiate whether legal restrictions derive from substantive or private international law. Restrictions are not solely conceivable from the perspective of the supplier. Likewise, the consumer's freedom of choice can be affected, as he is considered to be a a recipient of services available throughout the Community.

The specific restrictions caused by private international law in the various Member States derive from mandatory rules of conflict which impose the domestic law to be applicable to cross border transactions.

Banks, intending to operate by way of providing services directly throughout the internal market, would in this situation
have to adapt their legally determined products to twelve different legal systems in respect of mandatory provisions.

The outcome would, contrarily to Art. 59, produce restrictions equivalent to administrative control as far as the law applicable belongs to the body of mandatory rules. In this respect, a bank is not able to stipulate derogating standard terms as it could do with permissive provisions.

By selecting the applicable law, mandatory rules of conflict thus are eligible either to restrict or to ease the free movement of services. 102 As a result it is justified to presume that private international law rules existing in the Member States can be regarded as a potential restriction to the freedom of services where they restrict the parties' autonomy to choose the proper law for their commitment.

Though the EEC Treaty neither does explicitly refer to private nor to private international law, legal harmonisation in the EC actually has been widened to choice of law rules. Implementation can be achieved, on the one hand, positively, namely by way of secondary EC law.

On the other hand, Art. 59 EEC Treaty is enforced "negatively" by way of interpreting Member State law in compliance with the Treaty or even setting it aside where it leads to an unjustified restriction of the freedom to provide services. 103

The latter method, according to the rule of the European Court in the insurance cases, will apply where existing conflict of law

102 For the similar case of insurance see Roth, VersR 1993, 129 with references to relevant ECJ judgments.

103 Brödermann, MDR 1992, 89, 90 with further references.
rules in the Member States do not safeguard a commendable interest of the general good.\footnote{\textsuperscript{104}}

As to positive integration, the relevance of private international law for the internal market becomes obvious if one keeps in mind that differences of substantive law between the Member States will remain even in a long term perspective.

Harmonisation in this field does not always contrive to keep pace with the opening of markets. The problem of the law to be applied will therefore continue to arise as long as substantive law is not unified.

At the same time, in an internal market there will be a growing number of cases in which the courts have to apply foreign law. This was at least the perspective after the adoption of the Brussels Convention 1968 enabling the parties to enter into commitments assigning jurisdiction to and choosing among several courts.\footnote{\textsuperscript{105}} The result was that the plaintiff gives preference to the court of a State the law of which seems to offer a better forum for legal action.

In order to prevent this "forum shopping", to increase legal certainty, and to anticipate the law which will be applied more easily, uniform rules of conflict should ensure that the same law is applied irrespective of the State in which the decision is given.

\footnote{\textsuperscript{104} As already assumed in the case of direct and life insurance; cf. Roth, VersR 1993, 129; Smulders/Glazener, 29 CMLRev [1992] 775; E. Lorenz, ZVersWiss 1991, 121, 139.}

\footnote{\textsuperscript{105} Cf. Art. 5, 6 of Brussels Convention of 27.9.1968, on Jurisdiction and Enforcement of Court Decisions in Civil and Commercial Matters, as amended on 9.10.1978, cf. O.J. 1978 L 304/1.}
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Common rules of private international law consequently are deemed to reconcile the arising conflicts of open markets and deeply-rooted differences in the various private legal systems of the Member States.

1. The Rome Convention of 1980

In order to examine the relevance of harmonised rules of conflict in the sphere of banking services, one previously has to refer to the Rome Convention 1980 (RC) on the law applicable to contractual obligations\(^{106}\) which, along with the Brussels Convention 1968, represents the core of European private international and procedural law.\(^{107}\)

This international law based Treaty among Member States of the EC can only indirectly be regarded as EC law.\(^{108}\) It has been initiated in 1967 for the first time and was finally adopted by the contracting States on the 19th of June 1980.

According to the procedure chosen for its implementation, the Convention has since then been ratified successively and

\(^{106}\) O.J. 1980 L 266/1; cf. the trilingual promulgation in BGBI. I 1986, 810.

\(^{107}\) For recent developments see the annual overview given by Jayme/Kohler, IPRax, 1993, 357.

\(^{108}\) As for the legal basis, it was the unanimous view during the legislative process, that the Convention without being specifically connected with the provisions of Art. 220 of the EEC Treaty, would be a natural sequel to the Convention on jurisdiction and enforcement of judgments (note 105); see Guiliano/Lagarde, Report on the Rome Convention, O.J. 1980 C 282/5.
transformed or incorporated in the legal systems of the contracting states. The Convention for that reason is in force only since the 1st of April 1991, due to the ratification by the required number of contracting states.\textsuperscript{109}

With the exception of Portugal, the Convention has become domestic law in all Member States, either by transforming it directly or by way of incorporation into existing codifications.\textsuperscript{110}

The Rome Convention shall not affect the application of secondary Community law provisions laying down choice of law rules relating to contractual obligations (Art. 20 RC). Relevant regulations enacted by the EC or various Member State provisions based on the implementation of directives hence will take precedence.

The Governments of the Member States have, nevertheless and in a joint declaration, expressed the intention that secondary Community measures will be consistent with the provisions of the Convention. It is, however, conceivable that the Convention is comparatively accessible to consumer concerns while those efforts

\textsuperscript{109} In Spain and the Netherlands, the Convention is in force since 1.9.1993.

\textsuperscript{110} In Germany, the Convention has been incorporated into the private international law statute, cf. Art. 27 to 37 EGBGB as amended by statute of 25.7.1986, BGBl. II 809; see also the memorandum in BT-Ds 10/503, pp. 36 - 79: the provisions of the Rome Convention in Germany thus can neither be applied immediately nor do they prevail the provisions of Art. 27 ff. EGBGB. On the contrary, the German provisions of the EGBGB have to be applied autonomously, albeit their interpretation has to regard the Convention's main objectives; cf. Palandt-Heldrich, Kommentar z. Bürgerlichen Gesetzbuch (53th ed.), Vorbem. zu Art. 27 EGBGB, No. 1.
under the rule of Art. 57 II EEC Treaty were not primarily intended and therefore met with caution.

1.1. Freedom of Choice

Before the relevance of the Rome Convention to banking contracts is examined it is useful to list its characterising elements.\(^{111}\)

To start with, the Convention reaffirms in Art. 3 I the general principle of freedom of choice saying that a contract is governed by the law expressly chosen or implied by the parties\(^{112}\) when such a contract is connected to more than one country.

The lex contractus according to Arts. 3 to 6, 12 RC also governs the consequences of nullity of the contract (Art. 10 I e RC). It is thus an exception to the general scope of the Rome Convention which applies solely to contractual obligations.\(^{113}\) The law chosen for the contract thus determines contractual as well as non-contractual consequences of nullity, among them remedies related to unjust enrichment, damages or cancellation.\(^{114}\)

\(^{111}\) For an comment see Lando, 24 CMLRev [1987] 159, at p. 166.

\(^{112}\) An implied choice must be demonstrated by reasonable certainty by the terms of the contract or the circumstances of the case, Art. 3 I 2 RC.

\(^{113}\) However, the Proposal submitted by the Commission in Dec. 1972 indeed was extended to extra-contractual obligations; the Proposal’s German text is promulgated in RabelsZ 38 [1974] 211.

\(^{114}\) Einsele, JZ 1993, 1025 with further references.
Where, besides the lex contractus, all other elements of the contract are connected with one country only, the mandatory provisions of that country will apply - Art. 3 III RC.

This is the sole requirement related to the admissibility of choice of law agreements, while e.g. in Germany former law did require that such a commitment was justified on "commendable grounds".115

1.2. Absence of choice

In default of an expressed or implied choice of the parties, the contract shall be governed by the law of the country with which it has the closest connection, Art. 4 I RC. In order to determine that country, presumptions are made in Art. 4 II to IV to which the connecting factor of "characteristic performance" (Art. 4 II RC) is, at least for services, of outstanding importance.

A close connection is accordingly presumed with the country where the party which is to effect the performance being characteristic for the contract has his habitual residence or - when that party acts within his profession or trade - his principal place of business (Art. 4 II 1,2 RC).

When, under the terms of a contract, the performance is to be effected through a place of business other than the principal place of business, the law of the country in which that secondary place of business is situated shall apply (Art. 4 II 3 RC).

As the Rome Convention does not give any hints to define the term "other place of business" one has to refer to the judgments

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115 See v. Hoffmann, IPRax 1989, 261, at p. 262 with further references.
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central with the application of Art. 5 V of the Brussels Convention (BC).\textsuperscript{116}

By formulating an exception to the basic rule of judicial jurisdiction (cf. Art. 2 BC), under certain circumstances the Brussels Convention allows for a connection of the lawsuit with the place where the defendant being a body corporate has his secondary place of business.

Hence, where a dispute is arising out of the operations of a branch, agency or other establishment, the defendant can be sued before the courts of the place in which the branch, agency or other establishment is situated.

The meaning of the three terms in question according to the European Court should be determined autonomously, i.e. should be given a "Community law" meaning in the context of the Convention. On this basis the Court declared, that

"the concept of a branch, agency or other establishment implies a place of business which has the appearance of permanency, such as the extension of a parent body, has a management and is materially equipped to negotiate business with third parties so that the latter, although knowing that there will if necessary be a legal link with the parent body, the head office of which is in other Member States, do not have to deal directly with such a parent body, but may transact business at the place of business constituting the extension."\textsuperscript{117}


\textsuperscript{117} Case 33/78, Somafer/Saar-Ferngas - [1978] ECR 2183, 2192 at No. 12; see also Case 139/80, - Blankaert and Willems v. Trost - [1981] ECR 819.
By applying that rule to the interpretation of Art. 4 II 3 RC "the other place of business" must be in fact subject to the direction and control of the parent body and a place where business is carried on permanently.

The provision therefore does not comprise subsidiaries as they are - due to their legal independency - normally considered to operate without being subject to supervision of a parent body.\textsuperscript{118}

The provision furthermore does not apply where the place of business is only chosen for the conclusion of a contract as it cannot be regarded as permanent centre of business activities.

In context with the freedom of establishment pursuant to Art. 52 EEC Treaty the provision of Art. 4 II 3 does not seem to interfere the principle of home country control: even if the basic freedom of Art. 52 is interpreted not just as a non-discrimination clause but as a general prohibition of restrictions to the right of establishment\textsuperscript{119}, the application of law of the country where the head office is situated can be achieved by means of a choice of law clause.

Notwithstanding the latter remarks, the presumption to be made pursuant to Art. 4 II RC can be disregarded if the characteristic performance cannot be determined or the contract actually has a closer connection to another country (Art. 4 V RC).


\textsuperscript{119} Case 19/92, Kraus - of 31.3.1993, to be published.
1.3. Severability

In general, the law chosen applies to the whole contract. Nevertheless, the parties are enabled for instance to exclude certain elements of the chosen law, e.g. mandatory provisions, by means of severability, Art. 3 I 3 RC.

This concept acknowledges the parties' assignment to divide a contract into elements which can be governed by different laws. It has to be stressed that the parties thus are enabled to derogate from mandatory provisions of the lex contractus.

Party autonomy granted by the Convention's principle of free choice of law at first sight therefore follows a deregulating concept.\textsuperscript{120}

As the Convention has not been initiated to cut down consumer protection by way of unrestricted choice of law rules it attempts to recognize the consumer's interest in being protected by mandatory provisions of that country where he is habitually resident.

The resulting danger of using the means of severability to avoid certain standards of consumer protection, according to the Convention shall therefore be eliminated by arts. 5 and 7.

1.4. Consumer Protection

Most notably, Art. 5 introduces specific conflict rules for certain contracts concluded with a consumer. Its material scope is circumscribed by a legal definition of consumer contracts, comprising the supply of goods or services as well as the provision of credit for that object.

\textsuperscript{120} v. Hoffmann, IPrax 1989, 261, at p. 263.
The wording of Art. 5 thus extends to credit sales as well as to cash sales but seems to exclude mere consumer credits which are not concluded for purposes of finance procurement.

The provision nevertheless applies to insurance services, albeit the Convention's application in respect of the single market is restricted by prevailing choice of law provisions laid down in EEC-Directives on the insurance sector (Art. 1 III Rome Convention).

The personal scope of consumer protection is confined to natural persons who primarily act outside their trade or profession.

Art. 5 II embodies the principle that a choice of law in a consumer contract cannot deprive the consumer of the protection afforded to him by the law of his residence.

This basic restriction, however, only applies under certain circumstances set out in the three indents of the provision, hereinafter called the situative scope of application. For the intention of this paper it is sufficient to introduce these issues not in general but in connection with concrete examples of banking services.

Where all preconditions of Art. 5 are fulfilled, the parties' agreement of choosing the law of a certain country is not void. The contract will still be governed by the lex contractus. Where the chosen law does not afford the protection the consumer would have had in the country of his habitual residence, the contract is additionally governed by the mandatory provisions of that country.

In consumer cases, a comparison has therefore to be made between the provisions of the law chosen and the law which would have protected the consumer without that choice of law agreement.
As a result, private autonomy is replaced by the principle that the law being more favourable for the consumer, applies.\textsuperscript{121}

Art. 5 III RC introduces an exception to Art. 4 in the absence of choice: a contract made by a consumer is governed by the law of the country in which the consumer is habitually resident if the contract is concluded under the circumstances described in Art. 5 II RC.

It remains to be seen how this approach is workable in practice, in particular to what extent the comparison will actually be effected by the courts. Judicial control of choice of law agreements henceforth presumably will become more flexible.

In addition, the concept at least in theory seemingly is influenced by the mutual recognition approach, its starting point being the equivalence of consumer protection standards in the Member States.

The practical implementation of the solution found by the Rome Convention thereby will reveal whether the premise of equivalent consumer protection really exists. It is thus an approach which indirectly will influence the extent and necessity of forthcoming EC-harmonisation of substantive private law.

At the current stage of harmonisation, however, the concept of consumer protection through harmonised conflict rules does not seem to be fairly coherent as one regards prevailing conflict rules laid down in secondary EC law. The EC Directive on Unfair Terms in Consumer Contracts\textsuperscript{122}, e.g., seems to modify the

\textsuperscript{121} Mankowski, RIW 1993, 453, at p. 459.

\textsuperscript{122} O.J. 1993, L 95/29 et seq.; the Directive's substantial contents will not be dealt with in this paper; for relevant comment in general see Reich, op.cit. (note 101) at Nos. 164 - 166; Eckert, WM 1993, 1071; Ulmer,
concept of consumer protection as laid down in Art. 5 Rome Convention. Art. 6 II and states that the Member States shall ensure that the consumer may not loose the protection granted to him by the Directive due to the choice of law of a third country. The Unfair-Terms-Directive thus does not coincide with the Rome Convention's universal approach (cf. Art. 2 RC) according to which even in consumer cases the choice of a Non-Member State law does not necessarily lead to a connection with harmonised EC law. 123

Another incoherence with the Rome Convention can be found in the conflict rules as provided for in the Directives on insurance. Insurance products - at least those offered to the "passive" consumer - by now have remained to be the only "sensitive good" recognised by the EC legislator in accordance with relevant ECJ judgments. 124

Consumer protection thereby is expressed by specific choice of law rules in the directives on Non-life insurance as far as mass risks are concerned as well as life insurance. In principle, the law of that country applies where the risk is situated resp. to where the holder of a life insurance policy is domiciled. 125 Like the provisions of the insurance directives, Art. 5 RC is intended to

EuZW 1993, 1817; for the impact on German banking contract law see also Reich, in: Horn, Die AGB-Banken 1993, at p. 43.

123 Jayme/Kohler, IPrax 1993, 357; as well as for other recently adopted conflict of law rules based on EC secondary law mentioned there.


protect the consumer against a choice of law which deprives him from the protection afforded to him by the law of his home country. However, Art. 5 only ensures the application of mandatory rules of the home country of consumer, whereas the rules of the insurance directives provide for the application of the law of the home country in its entirety.\textsuperscript{126}

1.5. Mandatory Provisions

Irrespective of the protection granted to the consumer in Art. 5 RC, a court can give effect to mandatory provisions of the forum state (Art. 7 II RC) or, provided a close connection to that country, even to mandatory provisions of a third state (Art. 7 I RC).

These provisions have been highly criticised in legal writings, inter alia during the legislative process\textsuperscript{127} which cannot be dealt with here. With regard to Art. 7 I RC, the contracting states were given the optional choice whether they wanted to admit the application of mandatory foreign law in general or not (Art. 22 RC).\textsuperscript{128}

In respect of consumer protection difficulties may occur from the relationship between Art. 5 and 7 RC: mandatory rules according to Art. 7 have to be delimited from those named in Art. 5 II RC.


\textsuperscript{128} The reservation e.g. has been made by Germany.
On the one hand, according to Art. 5, the application of mandatory rules protecting the consumer in his country of habitual residence depends on a comparison with the protection guaranteed by the provisions of the chosen law.

On the other hand states Art. 7 II RC that rules of the forum state can be applied in a situation "where they are mandatory irrespective of the law otherwise applicable to the contract".

Consequently, when the forum state is the country of the consumer's habitual residence, both provisions of the Convention seem to overlap and accordingly have to be delimited. Otherwise the comparison to be made according to Art. 5 RC could be evaded by basing an application of mandatory rules directly on Art. 7 II RC. Moreover, it is left to interpretation whether an application, refused on basis of Art. 5 RC, can be achieved on grounds of Art. 7 II RC.129

It has therefore been argued that Art. 5 II and 7 II of the Convention have different implications: whereas the former refers to mandatory private law rules, the latter is assumed to be related to provisions deriving from public law not intending to balance the contractual relationship between the consumer and the supplier.130

Another opinion does not want to exclude private law rules in general from Art. 7 II RC and suggests to bring at least those provisions under its scope which derive from specific legislation on consumer protection.131

129 This solution was discussed in the "Gran-Canaria-cases", for references see Reich, op.cit. (note 101), at No. 155.

130 Mankowski, RIW 1993, 453 et seq., concerning the similar provision of Art. 34 EGBGB.

131 v. Hoffmann, IPrax 1989, 261, at p. 266.
The German legislator in this respect has pointed out that the application of mandatory rules shall be dismissed where there are no specific rules on consumer protection already laid down in regard of Art. 5 (resp. Art. 29 EGBGB).\textsuperscript{132}

It has therefore recently been recognised by the German BGH that Art. 7 II RC (Art. 34 EGBGB) shall apply where the protection by Art. 5 RC (Art. 29 EGBGB) is incomplete.\textsuperscript{133} This view takes into account that the contracting States have adopted Art. 7 II RC in order to ensure the application of mandatory rules in the area of consumer protection.\textsuperscript{134}

The controversy nevertheless shows that in this respect the Convention does not provide for legal certainty. At least in the field of banking services, where consumer protection in the Member States is based on private as well as on public law, the definition will cause difficulties.

Finally, another critical issue, just to be mentioned here, emerges from Art. 7 RC as to delimit reservations based on public policy according to Art. 16 RC. Neither the Convention nor the commenting report by Guiliano/Lagarde give further hints to how to define the provisions' contents or how to delimit them from each other.

\textsuperscript{132} BT-Drucks. 10/504, p. 83.

\textsuperscript{133} BGH WM 1994, 17; see also v. Hoffmann, IPrax 1989, 261 at p. 264; Grundmann, IPRax 1992, 1, at p. 4.

\textsuperscript{134} See Guiliano/Lagarde (note 108), p. 60.
2. Relevance for Banking Contracts

2.1. Freedom of Choice

The Convention's freedom of choice concept basically also applies to banking contracts including the means of severability.\textsuperscript{135}

A first restriction has to be regarded where a contract related for instance to a bank account is only connected with one country (Art. 3 III RC). Mandatory rules of that country will still govern the contract.

This solution, compared with the emphasis put on the freedom of choice principle in general, is not convincing in every respect, as it does not even allow the examination whether the chosen law is more favourable to the vulnerable party as provided for in Art. 5 RC.\textsuperscript{136} The consumer as a result cannot derogate from possibly inadequate mandatory rules if contracting with his local bank.

2.2. Absence of Choice

To the extent that the law applicable to the contract has not been chosen by the parties, the contract shall be governed by the law of the country with which it is most closely connected, Art. 4 I RC.

\textsuperscript{135} In Germany, the general contract terms for banking services contain a choice of law clause, stating that the law applicable is German law corresponding to the place of performance (No. 26 I 2 AGB-Banken). However, the clause only applies to traders resident in the FRG. Commitments with traders from other countries are admissible according to the law of the relevant country.

\textsuperscript{136} Lorenz, RIW 1987, 569, at p. 574.
The concept of "characteristic performance" imposed by paragraph II of that provision includes the premise that in a legal relationship between two parties each obligation has to be assessed separately irrespective of the economic or legal connection those single contracts may have.\textsuperscript{137}

The functioning of this principle can be explained by the example of a third party guarantee\textsuperscript{138} to which the "separation-rule" likewise applies. Where a third party secures the credit of a debtor, the fact that the contract is concluded for the sole reason to secure a credit does not have effect to the law applicable.

Irrespective of the law governing the secured obligation, the law applies according to the place of characteristic performance unless the parties have committed a choice of law agreement. The characteristic performance of third party guarantee is delineated by the liability of the guarantor.

As a result, the third party guarantee is protected by the law of his habitual residence.\textsuperscript{139} Where a contract in all respects is connected more closely to another state, the law of that country shall apply.\textsuperscript{140}

The law applicable is decisive for all issues deriving from the contract as regards the third party guarantor's obligation to pay


\textsuperscript{138} The third party guarantee cannot be considered to fall under the scope of Art. 5 RC and is thus accessible to choice of law clauses.

\textsuperscript{139} Palandt-Heldrich, Art. 28 EGBGB, N. 20; cf. also LG Hamburg, RIW 1993, 144, cited at Jayme/Kohler, IPrax 1993, 369 for the application of German law.

\textsuperscript{140} Reithmann/Martiny, op.cit. (note 116), No. 507.
whereas the question as to what he has to pay is governed by the lex contractus of the secured credit agreement.

Other types of credit are, where not falling under Art. 5 RC, in the absence of choice governed by the law of the country where the bank has its place of business (Art. 4 II 1 - 3 RC).

A performance is characteristic where it is "labelling" the contract. A credit is characterised by the bank's performing act of lending money to another person.

Without any difficulties a credit agreement can be connected with the law of the country where the bank has its head-office, as long as the latter has to effect the characteristic performance, i.e. to lend a certain amount of money to a client.

Given that a credit is taken from a Dutch bank by a client habitually resident in Germany, the contract will be governed by Dutch law, notwithstanding the likely agreement that the money is transferred through a German subsidiary, branch or agency. In terms of the Second Banking Directive the operation can be categorized as a "provision of services" in sense of Art. 59 EEC Treaty.

Where a credit under the terms of the contract is conferred by a branch not just functioning as the place of conclusion or payment, then it is to be governed by the law of the country where the branch is situated. Art. 4 II 3 RC reveals in this regard that the principle of home country control introduced for branches by the Second Banking Directive does not find a parallel solution in the field of Private International law.

The problem where the "characteristic performance" is to be located also occurs in cases where the contract is concluded with a "permanent presence" without being clear whether it can fulfil the categories of "other than the principal place of business" in terms
of Art. 4 II 3 RC. For the scope of the Second Banking Directive this question has been denied.141

The Rome Convention in this respect demands for a certain equipment with local office rooms, separate management etc.142 whereas a "permanent presence" is not necessarily connected with the host country locally.

However, where the requirements of Art. 4 II 3 RC are not fulfilled, this does not necessarily call for a closest connection of the agreement with the country of the head-office. On the contrary, an overall view pursuant to Art. 4 V RC will likely find the closest connection with the host country.

An exception to Art. 4 II RC is made for mortgage credits secured by property rights. By adopting the internationally acknowledged principle of the so-called Lex Rei Sitae, the Convention contains a sub-exception in Art. 4 III RC according to which by way of presumption the law of the country where the property is situated will apply.143

A mortgage credit contract consequently - by disregarding the presumption of "characteristic performance" - has the closest connection to the country of the property and is thus governed by the same law.

141 See supra, III.C.3.

142 [1978] ECR 2183, 2192; Reithmann-Martiny, op.cit. (note 116), No. 83; Rosenau, RIW 1992, 879, 882 et seq.

2.3. Consumer Protection

Banking services are subject to consumer protection applied by the Convention if they can be qualified as "consumer contracts" according to Art. 5 I RC. Its application on banking services hence requires a contract on the supply of services or the provision of credit for this object.

Though the term "services" is not further defined by the Convention and thus allows for extensive interpretation\(^\text{144}\), it is considered that credits, being conferred independently from a sale of goods or the financing of services, do not fall under the scope of Art. 5 I RC.\(^\text{145}\)

Having regard to the far-reaching interpretation of "services" in primary EC law and its increased relevance for both the banking industry and the consumer, this outcome is not persuasive. An exclusion of consumer credits would moreover not coincide with the approach laid down in the Second Banking Directive according to which the supply of consumer credits shall benefit of the principle of mutual recognition.\(^\text{146}\)

Even financing credits as referred to in the material scope may not fall under Art. 5 RC if the contract is concluded for professional purposes of the borrower. Relevant consumer protection rules in the Member States extended to the establishment of business stipulated for instance in the German

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\(^{144}\) Kroeger, Der Schutz der marktschwächeren Partei im Internationalen Vertragsrecht, (1984), at pp. 48.

\(^{145}\) Bülow, EuZW 1993, 435, at 436; Palandt-Heldrich, Art. 29 EGBGB N. 2 a; Reithmann/Martiny, op.cit. (note 116), No. 439.

\(^{146}\) See Reich, op.cit. (note 101), No. 155.
Verbraucherkreditgesetz (§ 1 I) do therefore not coincide with the personal scope of Art. 5 I RC.

As a result, such a protection can be derogated from 'by way of choice of law clauses' irrespective of the protection the borrower in those cases possibly will retain from Art. 7 II RC.

The situative scope of Art. 5 II RC as regards banking services shall, however, only apply under certain conditions set out in the three indents\(^{147}\) of that provision.\(^{148}\)

The first indent is related to a situation in which a bank has taken certain efforts to market financial services in the country where the potential customer resides. Besides individual proposals through middlemen, it is intended to cover certain acts such as advertising in the press, on the radio or television as well as by catalogues specifically aimed to that country.

To give an example, Art. 5 II RC assumingly applies in cases where a French bank solicits for deposits in German newspapers.

As the provision thus involves contracts normally concluded by correspondence, the place of conclusion could be doubtful. In order to avoid legal uncertainty the words "steps necessary on his part" express that any action taken by the consumer in his home country in response to an offer or advertisement is sufficient to determine the place of conclusion.

The second indent refers to all situations where the bank or an agent has received the order in the country where the consumer is

\(^{147}\) Of which the third, concerning the sale of goods by way of "border-crossing excursion", will not be dealt with here.

\(^{148}\) See for the following Guiliano/Lagarde, loc.cit. (note 108), at p. 23 et seq.
habitually resident. The word "agent" is intended to cover all persons acting on behalf of the bank.

2.4. Mandatory Provisions

Where the customer cannot invoke the protection granted by Art. 5 RC due to its relatively complex and restricted requirements, he presumably is protected by an immediate application of mandatory rules according to Art. 7 II RC. Its precondition, namely the international validity of mandatory rules, has to be examined by way of interpretation.\textsuperscript{149}

The debtor's right to terminate a credit agreement based on variable or interest rates provided for in the German Civil Code (Sec. 609a BGB) according to paragraph 4 of that provision is a mandatory rule. By virtue of being a provision deriving from specific consumer legislation, it is assumed that the rule will apply irrespective of the law chosen by the parties.\textsuperscript{150}

The presumption to be made pursuant to Art. 4 II RC can be disregarded if the characteristic performance cannot be determined or the contract actually has a closer connection to another country (Art. 4 V RC).

In general, the law chosen applies to the whole contract. Nevertheless, the parties are enabled for instance to exclude certain elements of the chosen law, e.g. mandatory provisions, by means of severability, Art. 3 I 3 RC.

\textsuperscript{149} See for consumer credit, v. Hoffmann, IPrax 1989, 261.

\textsuperscript{150} Ibid., at p. 271.
This concept acknowledges the parties' assignment to divide a contract into elements which can be governed by different laws. It has to be stressed that the parties thus are enabled to derogate from mandatory provisions of the lex contractus.

Party autonomy granted by the Convention's principle of free choice of law at first sight therefore follows a deregulating concept.\footnote{Ibid. at p. 263.}

As the Convention has not been initiated to cut down consumer protection by way of unrestricted choice of law rules it attempts to recognize the consumer's interest in being protected by mandatory provisions of that country where he is habitually resident.

The resulting danger of using the means of severability to avoid certain standards of consumer protection, according to the Convention shall therefore be eliminated by arts. 5 and 7.

\textbf{D. Other Functional Regulation}

\textit{1. Mortgage Credit}

The Commission's Proposal on the liberalisation of mortgage credit\footnote{Modified Proposal COM (87) 255 final; O.J. 1987 C of 19.6.1987.} has not been taken up again. Whereas one comment states the Proposal's objectives are entirely covered by the Second Banking Directive\footnote{Wolf, WM 1990, 1941; Bellinger, Der langfristige Kredit 1988, 567.}, it is more likely that the EC legislator wants
to evaluate the effects of liberalisation before further action will be taken.\textsuperscript{154}

However, some intentions of the Proposal have been taken over by the Second Directive, as the latter has extended the range of liberalised banking activities to mortgage credits. The Proposal was concerned with the implementation of the freedom of establishment and provision of services as regards mortgage credit institutions.

It was the Proposal's intention to ensure that institutions, legally defined in the Proposal, are enabled to offer mortgage credits throughout the Community.

Liberalisation of institutional control thereby should have been extended to finance institutions while, under the Second Directive, the principle of mutual recognition in this respect is only granted according to the preconditions required in Art. 18 II.

The mutual recognition of financing techniques, making up the core of the drafted Directive and formerly mentioned in the Second Banking Directive as well, has not been resumed yet. The rejection of this far-reaching concept, having striking effect on national property law, is not surprising since no efforts related to minimum harmonisation were pursued beforehand.\textsuperscript{155}


As a result, the liberalisation of mortgage credits is confined to the market access as valid for the activities of credit institutions in general.\textsuperscript{156}

2. \textit{Deposit Guarantee Schemes}

Deposit guarantee schemes are established in order to safeguard depositors where a credit institution has or will go bankrupt. Existing differences of protection in the EC are contrary to the internal market goal. Where a depositor has to fear much less protection of his deposits than usually granted in his home country, it is very unlikely that he will take his money to credit institutions in other Member States.

Harmonisation at EC level is therefore aiming at reconciling the redress schemes already established in the majority of Member States on the one hand, with banking systems such as Greece and Portugal on the other hand still not having provided for deposit guarantee schemes at all.

Additionally, the Community-wide establishment of deposit guarantee schemes will contribute to the prevention of instabilities of the finance market due to single bank failures.

After having recommended voluntary schemes in 1986, the Commission has recently proposed a binding Directive.\textsuperscript{157} The

\begin{footnotesize}
\textsuperscript{156} Schneider/Troberg, WM 1990, 165, 169; according to Eilmansberger, EuZW 1991, 698, the Second Directive even in this respect is not sufficient.

\end{footnotesize}
proposal thus imposes the compulsory membership of credit institutions to redress schemes (Art. 2 I) based on the mutual recognition of already existing systems in the Member States.

An exception of compulsory membership is admissible where a credit institution is attached to a recognised protection scheme related to the institution as such (Art. 2 III).

Harmonisation, however, shall be achieved as to the limits of redress. Henceforth, the minimum of cover funds will have to amount to 20.000, - ECU per each single deposit (Art. 4 I).\footnote{158}

The draft Directive's approach has thereby reflected the average of existing coverage in the EC leaving explicitly aside the schemes of Germany and Italy.\footnote{159} The comparatively high coverage in those countries is not considered to become standard throughout the Community as high coverage possibly would provoke a risky management by single institutions as well as unproportionate subscriptions.\footnote{160}

Art. 2 II provides for an optional right of the credit institutions to become member in the host country's redress scheme. The

\footnote{158} A survey of upper limits within national schemes already existing in the EC indicates the different protective levels achieved by Member State regulation:
Spain (11.700 ECU); Belgium (11.800 ECU); Luxemburg (11.800 ECU); Ireland (13.000 ECU); Netherlands (17.300 ECU); England (21.400 ECU); Denmark (31.000 ECU); France (57.500 ECU); Federal Republic (30 % of basic own funds per deposit); Italy (520.000 ECU!).

\footnote{159} See Zimmer, ZBB 1992, 286, at p. 297.

\footnote{160} COM (92) 188, supra note 157, Recital No. 9, at p. 7.
deviation of the home country control principle is in this respect is only a minor one: in the first place, this clause is not binding the Member States. If the latter provides for such an option at all, the decision to get attached to the host country's scheme is left to the credit institution. In every case, the covering by the home country and therefore the control will be upheld. Irregularities in the course of membership to the host scheme can be sanctioned with exclusion, but will not lead to further consequences as the home country membership is retained.

The choice to become a member of the system of the host country thus will only eliminate possible competitive disadvantages, as a higher level of protection will increase the institution's reliability in the public.161

Where a credit institution does not comply with its obligations, the home country authority has to take sanctionable measures (Art. 2 III). Again, the exclusion according to the scheme's articles will be possible, although this sanction is not supplemented by a withdrawal of authorization (Art. 2 III 2).

Where a Member State wants to uphold a higher level of protection this may not lead to a restriction of market access of institutions coming from other Member States. A credit institution intending to operate in another Member State has solely to indicate the membership to a scheme in the home country.162

However, this confirmation of the principle of home country control shall only apply where the depositor's guaranteed protection is lower in the home country than in the host country.

161 Zimmer, loc.cit. (note 159).
162 In Germany implemented by KWG sec. 23 a, 53 b III.
In other words, a credit institution attached to a scheme in its home country which confers a higher protection cannot import its standards into the host country whilst the market access of banks who do just comply with the minimum standard is not restricted at all.\textsuperscript{163}

This solution as amended in a common position of the Council\textsuperscript{164} would mean a remarkable deviation from the concept of mutual recognition in favour of a "bottom-down-policy". It thereby suggests that the concept does not apply where it leads to a cross border competition with standards going beyond the minimum EC level.

As to payment provisions, the Proposal imposes that redress has to be granted within three months after a deposit has become indisposible (Art. 7 I with Art. 1 I 3). While the legal form of guarantee schemes can be determined by Member State legislation, the problem arises by what legal remedy the redress can be enforced.

3. \textit{Payment Systems}

On the 8th of December 1987 the Commission introduced a Recommendation on a code of conduct relating to electronic

\textsuperscript{163} For a critique see Reich, EG-Richtlinien und internationales Privatrecht, 1993, to be published.

\textsuperscript{164} Of 25.08.1993; by the copy dead-line of this paper, the Directive has not yet passed the legislative process.
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payments.\textsuperscript{165} Though not legally binding, the Commission formulated principles on the contractual relation between finance institutes and retailers or suppliers of services on the one and consumers on the other side.

The code is solely concerned with electronic payments.

Efficient protection of the consumer moreover shall be promoted by a further recommendation on the relationship between card-holders and card-issuers which has been passed in 1988.\textsuperscript{166}

The measure contains contractual conditions governing the risk-sharing in case of loss, theft or forgery as well as the card-issuer's liability for non-performance or wrong performance of payment orders. The latter also includes the consumer's right of cancellation. Beside formal requirements like written form, the contract shall be drafted in a transparent manner and shall clearly inform the consumer about the calculation of fees.

As in the case of electronic cash banking industry organisations have successfully refused a binding regulation which is deemed to impede the currently rapid development in that sector and therefore considered as being disadvantageous for both, consumers and industry.\textsuperscript{167}

\textsuperscript{165} Recommendation COM 87/598/EEC; O.J. 1987 L 365/72; see also Fischer, WM 1989, 76.


\textsuperscript{167} Niehoff, FLF 1990, 278, at p. 279.
4. **Transparency of Banking Conditions**

Further principles of functional banking regulation by way of transparency rules have been recommended for cross border payments.\(^{168}\)

It is intended to ensure that customers are properly informed about costs and invoicing. A partial repayment is proposed where a transaction is not carried out in agreed time.

In addition, the Recommendation suggests the setting up of agencies responsible for the implementation of customer complaints. It has already been announced that the Commission is going to prepare further measures at EC level, esp. dealing with cheque payments which up this moment has not become subject of secondary Community law at all.\(^{169}\)

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\(^{169}\) The necessity of further Community action in this field has been confirmed recently by a study showing that the credit institutions in practice hardly adhere to the Recommendation's intentions; cf. note in EuZW 1993, 586.