The Community Directive on Investment Services

The Controversy on Mutual Recognition and Home Country Control

Poul Runge Nielsen[1]

1 Introduction

On 10 May 1993 the Council adopted the Investment Services Directive[2] (hereinafter the ISD). The Directive should have been implemented into national law no later than 1 July 1995 according to Art. 31(1).

Before the implementation of the Directive went a complicated and time demanding legislative procedure.[3] It falls beyond the purpose of this article to outline all the difficulties involved in the process, but some of the issues are noteworthy. Fundamental matters like the definition of an investment firm and the activities to be included, caused disagreements in the Council.[4] Furthermore, when comparing the securities business with a related sector, i.e. that of banking, it appears that the latter industry has, as a result of international initiatives, been subject to a relatively tight regulation.[5] In many Member States, this was not the

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1 Legal Service of the European Parliament. The views expressed in this article are purely personal and do therefore not reflect those of the European Parliament or any other Community Institution.

2 Council Directive 93/22 on Investment Services in the Securities Field. The Directive is published in the Official Journal of the European Union (hereinafter O.J.) 1993 L. 141/27.

3 It was originally intended that the ISD should enter into force in the Member States by 1. January 1993, according to the Commission's first proposal (Com(90) 141 final-SYN 257, submitted by the Commission on 30 April 1990. The proposal is published in OJ 1989 C 43/7 as amended in OJ 1990 C 42/7.

4 For a more detailed survey of the political implications in the Council see Ashall *in EC Financial Market Regulation and Company Law* (1993) p. 91 *et seq*.

5 The international framework governing the banking sector is mainly the Basle Committee. On this framework see e.g. Norton in Norton (ed*); Bank Regulation and Supervision in the 1990s*, p. 83 *et seq*.

case with investment services. It is therefore hardly surprising that the fundamental attitudes towards the future regulation of the investment services industry made it hard to reach a political compromise.

The aim of this article is provide for a survey of some of the most fundamental aspect of the Investment Services Directive, i.e. the division of powers between the home- and host state. Thus, the article does not provide for comments on each particular provision of the ISD, but comments some of the fundamental provisions that are most likely to cause legal tensions between the Community legal system and the national legal systems.

It should be noticed *in limine* however that although the Directive has been adopted by the Council, the national legal systems of the Member States are obliged to comply with the provisions of the ISD from 1 July 1995. This article does therefore reflect the legal obligations that Member States shall observe in their national legal systems. However, a Directive is according to Art. 249 of the Treaty not directly applicable in the national legal systems. It is directed to the Member States, but they are left with the discretion to decide the measures, which implement the Directive into national law. The legal position as it stands according to the Investment Services Directive does accordingly not necessarily reflect the legal position in the Member States of the European Community.[6] Furthermore, the ISD leaves a considerable amount of questions which the Member States are entitled to regulate. This is for example the case with issues that are governed by the *general good*, one of the concepts which are used repeatedly in the ISD, albeit not defined precisely.[7] Thus, the regulation of investment services is an interrelationship between Community law which prescribes the aims to be acheived by the Directive and national legislation filling out the gaps.

The subject matters that will be scrutinised in the following will include subjects relating to the scope of the ISD (subsection 2), the legal foundations in the EC Treaty (subsection 3), the legal methodology utilized (subsection 3.4.), the division of competence between the home and host state authorities with particular emphasis on supervisory aspects (subsection 4), access to the national stock exchanges and related markets (subsection 5).[8]

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6 It should be noticed that a Directive in exceptional cases can be directly applicable provided that the relevant provision is clear, unambiguous and unconditional. This principle is established in the European Court's case-law in case 41/74 *Van Duyn v. Home Office* [1974] European Court Report (hereinafter E.C.R.) 1337. If there requirements are met, individuals are entitled to claim the rights flowing from a provision in a Directive, but only in against the State or any other public organ being an extension of the State (case 152/84 *Marshall v. Southampton & South West Hampshire Area health Authority*, [1986] E.C.R. 723. For more details on direct applicability of Directives see e.g. Hartley*; The Foundations of European Community Law* (1994) p. 210.

7 See for example the 33rd recital of the preamble of the ISD which states that the Member States shall "ensure that there are no obstacles to prevent activities that receive mutual recognition from being carried on in the same manner as in the home Member State, as long as they do not conflict with the laws and regulations protecting the *general good* in force in the host Member State." (Emphasis added.)

8 Presently there is a terminological confusion as to the correct designation of the European Community. Until 1993, the legislative framework consisted mainly of the Treaty on the European Economic Community. On a conference held in the Dutch city of Maastricht, the heads of the governments agreed upon the Treaty establishing the European Union. This

2 Scope of the Investment Services Directive

2.1 Institutional Coverage

2.1.1 Legal Persons

Art. 2(1) of the ISD prescribes that the Directive "shall apply to all investment firms." An investment firm is defined in Art. 1(2) as "any legal person the regular occupation or business of which is the provision of investment services for third parties on a professional basis." This definition entails three elements. First, it is required that the undertaking must carry investment services as regular business activities. Secondly, it is a precondition that the carrying on of the investment services is on behalf of third parties. Thirdly, the involvement in the business of investment services shall be on a professional basis.

As a result of these conditions the occasional provision of investment services on a private basis is excluded from the scope of the Directive.[9] The definition also exclude e.g. lawfirms and accountants who may occasionally and incidentally give advise on investment services[10] or even in case they invest on their own behalf.

It seems to follow from the above mentioned requirements of the ISD, that a fundamental characteristic of the institutions covered, provided that are legal persons, that the key word is whether the activity is carried out on a permanent *and* professional basis. Expressed in more simplistic terms, it is a prerequisite for applying the ISD on any undertaking, that it is acting as a professional on the market on behalf of third parties. Undertakings which acts on their own account are by virtue of this approach not governed by the ISD.

The Directive contains a number of other exclusions from its scope. Some of the most important undertakings expressly excluded from the ambit of the Directive are insurance companies,[11] firms which provide investment services exclusively for

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treaty contains several important amendments to the Treaty on the European Economic Community. One of the changes is that the Treaty on the European Economic Community changes title to the Treaty on the European Community. But the essential features regarding the economic corporation between the Member States remains included in this Treaty, whereas the components of corporation in the field of foreign policy, defense policy and the common currency all are included in the Treaty on the European Union. Due to the fact that the subject for this article relates to the Treaty on the European Community, the terminology used in this article will be that of the European Community.

9 See also Goode in *The Single Market and the Law of Banking* p. 118.

10 This was suggested by Goode, *infra*, and follows now expressly from the preamble of the Directive (18. para) which prescribes that "the purpose of [the] (...) Directive is to cover undertakings the normal business of which it is to provide third parties with investment services on a professional basis; whereas its scope should not therefore cover any person with a different professional activity (e.g. a barrister or solicitor) who provides investment services only on an incidental basis in the course of that other professional activity, provided that that activity is regulated and the relevant rules do not prohibit the provision, on an incidental basis, of investment services."

11 It is noteworthy that the definition of an insurance company in the ISD is a Community definition by a cross reference to Arts. 1 in Directives 73/239/EEC (OJ 1973 L 228/3) Art. 1, and 79/267/EEC (OJ 1979 L 63/1). The legal background for this exclusion is explained in the Preamble of the ISD (para 16) as due to the fact that insurance undertakings are subject to

their parent undertakings or subsidiaries, undertakings that provide investment services which exclusively consists of administration of employee-participation schemes,[12] and firms which, according to national legislation, *inter alia*, may not place themselves in debt with their clients.[13]

2.1.2 Natural Persons

The Commission's original proposal contained merely a definition covering legal persons. However, in 1992 a compromise was reached in the Council by which also natural persons were included in the ISD.[14] According to Art. 1(2) of the ISD, Member States may include natural persons in the definition of an investment firm, provided that certain requirements are met.[15] In this respect the ISD differs fundamentally from the Second Banking Directive considering that the latter Directive merely covers legal persons. Thus, Member States cannot grant authorization to a credit institution in case it is not organised as a legal person.[16]

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appropriate monitoring by the competent prudential-supervision authorities and which are coordinated at Community level (...)

12 The Preamble (19 para) holds that this exclusion is founded on the submission that such undertakings do not provide investment services for third parties. It appears inconsistent with the of the main purposes of the Directive, which is to protect the investors (see in particular 2nd para of the Preamble), to exclude pension funds from the scope of the ISD. It appears hard to appreciate the practical need for this exclusion, considering that savings for pension purposes plays an increasingly important rôle on the financial markets in many Member States. The result of this omission is that pension funds are not (yet) governed by secondary Community legislation. This might result in lower profits for the employees due to the fact that pension funds have more difficulties in penetrating other markets of the Community. It might additionally be questioned why the employees are not considered as third parties towards the pension funds. The Danish associations set up by Danish pensions funds are excluded by Art. 1(k). On the legal position of pension funds see e.g. Zavvos in [1994] CMLRev 609.

13 Art. 1(g) contains some additional requirements to this type of undertakings.

14 Ashall, supra note 4, at p. 96.

15 It should be noticed that the national legal systems are not *obliged* to include natural persons in the definition of an investment firm. The formulation of the provision demonstrates that is it facultative for the Member States whether they will permit *their own* undertakings to be organized as natural persons. However, any host state will always be obliged to recognize a natural person authorized in another Member State to carry on investment services, irrespective of whether natural persons are barred from carrying out investment services according to the national legislation. This is a consequence of the principle of mutual recognition, which is dealt with below in subsection 3.5.

16 Although the Second Banking Directive is not explicit regarding this subject matter, the drafting of the provisions of the Directive makes it quite clear that natural persons falls outside the Directive's personal scope. For example in the 8th recital of the preamble is it stated that "a credit institution shall be deemed to be situated in the Member State in which it has its registered office" and that "Member States must require that the head office be situated in the same Member State as the registered office." For more observations on the personal scope of the Second Banking Directive see e.g. Runge Nielsen; *Services and Establishment in European Community Banking Law* p. 191. On the relationship between the Investment Services Directive and the Second Banking Directive, see below in subsection 2.2.

Art. 1(2) of the ISD directive requires that in case Member States include natural persons in the definition of an investment firm, their “legal status” shall ensure “a level of protection for third parties’ interest equivalent to that afforded by legal persons.” Furthermore, it is required that the natural persons shall be “subject to equivalent prudential supervision appropriate to their legal form.”

The two aforementioned conditions are not entirely clear. It is first required, that the “legal status” of the persons in essence shall ensure a sufficiently high level of protection for third parties. Construed literally, the requirement on the legal status could refer to the national requirements to the organisation of the business and more particular to requirements relating to the conduct of business. However, the requirement could also refer to the moral status of the person concerned, due to the fact that one of the purposes behind the Directive is to protect the stability and creditability of the market.

Considering that the ISD expressly leaves scope for the national legal systems to include natural persons within the persons entitled to invoke the Directive, the drafting of the provision appear rather unfortunate. Instead of having stated the specific requirements the national legal systems must impose upon natural persons reliance, the solution adopted by the ISD almost inevitably invites to conflicts between the national legislation and Community law. According to the present drafting of the provision, is it for example uncertain *which* interests of the third parties which shall be governed by the protection. It is thus uncertain whether it is the interest in avoiding conflicting interests between the person providing the investment service or the protection of the customer’s financial interests.

Leaving aside the discussion relating to the exact institutional coverage relating to natural persons scope of the ISD, it thus appears rather evident, that persons who do not meet the national requirements regarding the right to enter into contractual obligations, cannot rely upon the ISD. Secondly, is it assumed that in case the competent authorities have reason to doubt the moral suitability of the person concerned.[17]

The second condition refers to the prudential supervision of the investment firm “appropriate to [its] legal form.” It seems to follow from this obligation, that the competent authorities[18] are expected to perform the supervision of natural persons on other criteria than those applicable to legal persons. However, the provision leaves a considerable scope to the national supervisory authorities with regard to this question. In essence this requirement of the ISD may in reality lead to a more stringent supervision of natural persons than is the case with legal persons.

With a view to protect the clients’ money and assets the ISD contains in Art. 1(2) additional rules if the provision of such services involve the holding “third parties’ funds or transferable securities.” The substantial requirement in this

17 This submission has also some support in art. 3 of the ISD concerning the conditions for taking up business. According to this provision, the persons who direct the business of an investment firm, shall possess sufficiently good repute and sufficient experience.

18 The competent authorities are according to Art 1(9) the authorities designated in accordance with Art. 22. The ISD thus contains no rules as to how the supervisory authorities are to be organized. The only requirement which the Member States must fulfil is that the competent authorities must have all the powers necessary for the performance of their functions (Art. 22(3).

provision is broadly speaking that the investor's fund shall be protected against the investment firm's creditors and insolvency. Additionally, the national legal systems must ensure that the investment firm shall be subject to rules on disclosures. The rationale behind the rules is to separate the investor's assets and funds from those of the investment firm. It appears therefore appropriate to conclude that the investment firm is obliged to establish a separate account for each client.

2.1.3 Comments on the Scope of the ISD

It is clear from the text of the Directive, that it has severe implications for natural persons in the ambit of the ISD, and that natural persons deserve more attention than is the case with legal persons. It appears therefore hardly surprising that the Commission is obliged to draw up a report on the application of the rules regarding natural persons and if necessary to propose amendments or deletion of the rules.[19]

The (extended) institutional scope of the ISD as to cover also natural persons reflects the political attitude in the Council. The outcome is a political compromise, which, strictly speaking, does not serve the interest of legal certainty. There seems to be little justification for allowing natural persons to carry out investment services in the internal market. The principle of mutual recognition[20] will oblige a national legal system, which only permits investment services to be carried out by legal persons, to grant access for natural persons from other Member States, provided that the home state of the natural person is authorized to perform investment services.

It is therefore regrettable that the approach of the Second Banking Directive has not been followed in the ISD. The vaguely drafted provision which sets out the requirements natural persons shall meet is from a legal point of view hardly satisfactory. Even though the ISD is based on the principle of minimum harmonisation, there seems to be no justification for not harmonising the legal form that investment services may be carried out through. Additionally, the repercussions would have been very limited in the national legal systems if the ISD had barred natural persons access to the internal market in investment services. The requirements contained in the Capital Adequacy Directive[21] applies to both legal and natural persons carrying out investment services. Thus, there appears to be very little justification, from an economical point of view, for upholding the right of natural persons to engage themselves into the business of investment services. It is much to be hoped that the Commission will submit a proposal, which will delete the right for natural persons to invoke the ISD.

2.2 Observations on the relationship between the Investment Services Directive and the Second Banking Directive (SBD)

Considering that also banks, which correctly are designated as *credit institutions* in the terminology of the Second Banking Directive, hereinafter cited as the SBD,

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19 Art. 1(2) i.f. provides that the Commission is obliged to do so no later than 31 December 1997.

20 See below in subsection 3.4. for comments on the concept of mutual recognition.

21 Directive 93/6/EEC, OJ 15 march 1993.

traditionally also provide investment services[22] it is hardly surprising that the ISD contains rules which are applicable to credit institutions.

It is established in Art. 2(1), first sentence, that the ISD applies exclusively to all investment firms. However, according to Art. 2(1), second sentence, certain articles of the ISD applies also applies to credit institutions.[23] It follows thus, *a contario*, that credit institutions are otherwise excluded from the ambit of the ISD.[24]

Both the ISD and the SBD are founded on the principle of mutual recognition.[25] The activities subjected to mutual recognition are listed in Annexes to the Directives. It thus follows that a credit institution is not required to be authorized as an investment firm if it intends to provide investment services. The credit institution may provide investment services by virtue of its banking license, always provided that the authorization includes the activity in question.[26]

It is noteworthy that the Capital Adequacy Directive,[27] contains rules on minimum capital for investment firms and for credit institutions that provide investment services.[28]

It was originally the Commission's intention that the ISD should enter into force at 1 January 1993,[29] at the same time as the SBD.[30] The overlaps between the ISD and SBD illuminates why it was essential to link the legal acts together. The SBD is aiming at creating the single market for credit institutions providing both traditional banking services *and* investment banking whereas the purpose of the ISD is to establish the single market for non-banks providing investment services. This would have achieved a "level playing-field" between credit institutions and

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22 The Second Banking Directive reflects the "universal bank model" which allows banks to carry out commercial banking and investment banking, see e.g. Dassesse in *The Single Market and the Law of Banking* p. 73 and Runge Nielsen, supra note 16, p. 193 *et seq*. According to the list of activities subject to mutual recognition in the Annex of the SBD (item No. 8) credit institutions are entitled to provide investment services, always provided that they are authorized to do so by the competent authorities of the home state. In the case of the ISD it will be seen that this Directive governs investment services only and has thus a much more narrow scope than is the case with the Second Banking Directive On the importance of the list of activities for the application of both the ISD and the SBD see below in subsection 3.5.

23 Despite the wording Art 2(1) second sentence could be construed as meaning that the provisions only applies to credit institutions at the exclusion of investment firms. This submission is based upon the submission that some of the provisions of the ISD, which are applicable to credit institutions expressly mentions investment firm. If these provisions were to cover only credit institutions, the provisions would hardly have been worded that way. The provisions of the ISD which also applies to credit institutions are Arts. 2(4), 8(2), 10, 11, 12(1), 14(3) and (4), 15, 19 and 20.

24 See also Shea, in Cranston (ed); *The Single Market and the Law of Banking*, p. 120.

25 On the principle of mutual recognition see below in subsection 3.4.

26 See also Gruson and Feuring in *The Single Market and the Law of Banking* p. 32.

27 Council Directive 93/6, OJ 1993 L 141/1. The Capital Adequacy Directive applies to both credit institutions and investment firms.

28 The Capital Adequacy Directive will not be analyzed in the following. For the likely impact on the financial institutions of the Directive see e.g. Whittaker in [1994] Journal of International Banking and Financial Law p. 377.

29 Ashall, supra note 4, p. 92.

30 According to Art. 24 of the SBD.

investment firms. The legislative position as it stands today is that whereas there now exists a single banking license, valid throughout the Community investment firms are placed in a competitive disadvantage until the ISD enters into force on 1 July 1995.[31]

The substantial *principles* of the ISD resembles those of the SBD. This applies with respect to the list of activities, the division of powers between the competent authorities of the home state and those of the host state, the principle of mutual recognition and home country control, the legal foundations (i.e. the right of establishment and the freedom to provide services) and, to a certain extent, the administrative procedure which shall be initiated by the beneficiaries before commencing cross border activities. Some of these principles shall be dwelled upon in the following subsections.

3 Basic Principles of the ISD

3.1 Legal Foundations in the Treaty

According to the fundamental Community legislation, the pursuit of commercial activities can be performed either by means of the right of establishment (Art. 43 EC) or the freedom to provide services (Art. 49 EC). It is expressly stated in Art. 58 EC in conjunction with Art. 66 EC that the exercise of these freedoms also apply to legal persons.

It should be noticed that the application of these freedoms is conditional upon border crossing activities that is to say activities between Member States. Transactions carried on within the same Member State fall thus outside the scope of the Treaty provisions.[32]

The Treaty provisions on services and establishment constitute the legal foundation of the ISD. Accordingly, a correct understanding of the content of the ISD requires therefore at least a basic knowledge of the rights granted by these economic freedoms. The following subsections provide for a brief survey into the application of these rights, and the legal position according to the case-law of the European Court of Justice.

31 According to Art. 31 of the ISD. This means in principle that Member States are not obliged to comply with provisions of the ISD before this date. However, the Member States are always obliged to comply with the provisions of the Treaty, provided that they are directly applicable. The notion of direct applicability entails in practice that the provision shall sufficiently precise and requires not further action by the Council.

32 This applies only to the actual pursuit of activities. The ISD covers also matters which strictly speaking only have internal relevance, for example the conditions for obtaining authorization. However, such matters are necessary to include in the ambit of the Directive since it secures the level playing field for investment undertakings in the Community. On the content of the requirements for obtaining authorization see Ferrarini in [1994] Common Market Law Review 1283 at 1295.

3.1.1 Preliminary Observations

The corner stones of the ISD are the Treaty provisions on the right of establishment (Art. 43) and the freedom to provide services (Art. 49). This follows from the Preamble (1. recital) which states:

> "Whereas this Directive constitutes an instrument essential to the achievement of the internal market (...) from the point of view both of the right of establishment and of the freedom to provide financial services, in the field of investment firms."[33]

This statement is followed tightly in the ISD. Thus, Title V of the Directive contains rules on the exercise of both rights. Art. 14(1) lays down the general rule after which investment firms shall be entitled to carry on investment services throughout the Community. The relevant part of the provision reads:

> "Member States shall insure that investment services (...) may be provided within their territories (...) either by the establishment of a branch or under the freedom to provide services by any investment firm authorized and supervised by the competent authorities of another Member State (...) provided that such services are covered by the authorization."

It is a consequence of this statement that the Treaty's concept of right of establishment and freedom to provide services shall be applied in the context of the ISD. However, before turning into the substantial issue on the application of these fundamental Treaty rights in the ISD, it might be worth giving a brief introduction to these rights in general. Thus, in the following subsections it will be examined what these rights contains and thereafter the application of the rights in the ISD.

3.1.2 The Right of Establishment

3.1.2.1 Establishment in Community Law

The right of establishment is enshrined in Art. 43 EC. This Treaty freedom is traditionally divided into two separate categories, *primary* and *secondary establishment*. Whilst the former right entails that the beneficiary moves his centre for his economic activities from the home State to the host state, secondary establishment presupposes the existence of a primary establishment within the Community.[34]

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33 In this respect there seems to be tight accordance with the legal foundation of the SBD.

34 On the distinction between primary and secondary establishment see e.g. Vaughan; *The Law of the EEC* (1986) p. 465 (at para 16.04). Secondary establishment in the Treaty sense involves the right to "the setting up op agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State." (Art. 43(1) last sentence). It should be observed however, that the right to establish subsidiaries, which traditionally is considered as a means of secondary establishment, more rightly should be considered as primary rather than secondary establishment. This submission is based upon the fact that a subsidiary in all the national legal systems of the Member States is considered as the creation of a new legal entity. For a more detailed discussion regarding this subject matter see Runge Nielsen, supra note 16, p. 141-143.

According to the second paragraph of this provision the right of establishment entails the "right to take up and pursue activities as self-employed persons and to set up and manage undertakings (...) under *the conditions laid down for its own nationals* by the law of the country where such establishment is effected (...)". In the first paragraph of the provision is it stated that "*restrictions* on the freedom of establishment (...) shall be abolished by progressive stages in the course of the transitional period".[35]

This ambiguity in the wording of the provision[36] does not provide for any exact guidance as to what constitutes establishment within the meaning of the Treaty, neither does it hold exactly whether the right of establishment merely provides for non-discriminatory treatment in the host state or goes further to require the abolishment of all restrictions. Indeed the drafting of the first paragraph could lead to the assumption that the right goes further and thus requires not only discriminatory national provisions to be abolished but also national legislation that might impede the right of establishment.

In the following two subsections these questions will be examined further. First it will the requirements in the Court's case-law be outlined with particular regard to the concept of establishment. Secondly, the exact scope of the Treaty freedom will be examined with a view to conclude the extent to which the right of establishment may be exercised.

3.1.2.2 The Concept of Establishment

The wording of Art. 43 EC indicates that establishment refers to the pursuit of economic activities within a Member State. This approach has been confirmed in the Court's case-law. It falls beyond the purpose of this brief introduction to go into a detailed analysis of the existing case-law but some few cases deserves to be mentioned for the purpose of clarification.

The rulings, commonly known as the *Quota Hopping* cases,[37] illuminates both the scope of the provision and the concept of establishment. The background of the dispute shall be traced back to the Community's fisheries policy. Due to the shortage of fishing stocks in Community waters a quota system was introduced in the beginning of the 1980.[38] In this system each particular Member State was allocated a certain amount of fish to catch. It might thus be thought that the purpose behind the regulation at Community level, i.e. securing the Member States an equal part of the fishing stocks, that the Member States were allowed to reserve the quotas to their "own" fishing fleet. However, the Court had held in previous rulings

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35 Emphasis added.

36 I.e. the reference in the first paragraph to the *restrictions* that must be abolished in the course of the transitional period and the requirement in the second paragraph that the right of establishment includes the right to pursue activities under *the same condition*s as those applicable to the host state's own nationals.

37 Cases C-221/89 *R. v. The Secretary of State for transport ex parte Factortame Ltd and Others* [1991] E.C.R. I-3905, C-246/89 *Commission v. United Kingdom* [1991] E.C.R. I-4585, C-93/89 *Commission v. Ireland* [1991] E.C.R. I-4569. Considering that all cases concern virtually identical points of law reference will in the following be made to the first ruling.

38 The relevant rules were contained in Regulation 170/83, OJ 1983 L 24/1.

that this was not the case. In *Agegate* and *Jaderow*[39] the Court ruled that the purpose behind the Community's fishery policy could not legitimate a derogation from the prohibition against discrimination contained in Art. 43 EC.

In the *Quota Hopping* cases the Court was confronted with national legislation which, inter alia prescribed that, in order to become registered in the United Kingdom and thus entitled to fish against the British quotas, any vessel should be owned by British nationals, that the management or operator should be a British citizen, domiciled and resident within that state and that the vessel was to be operated and managed from within the United Kingdom.

The Court held that the two former requirements were contrary to Art. 43. The reasoning of the Court is founded on the discriminatory character of the national legislation. Particularly regarding the requirement relating to the residence and domicile of the operator or management it was held that since the great majority of nationals in a Member State were nationals of that state, the national legislation was contrary to Art. 43. It might be worth mentioning that the national legislation subject to scrutiny in the *Quota Hopping* cases were not directly discriminatory, albeit indirectly.

The third aspect of the *Quota Hopping* cases relates to the national requirement on operation and management from within the United Kingdom. Such preconditions may indeed have the effect of being an impediment to the right of establishment considering that national of other Member States could not manage a vessel from their own residence or domicile. However, the Court explained that this aspect was not contrary to Art. 43 EC since the concept of establishment in itself implies that an activity must be performed from the Member State in which the potential beneficiary intends to become established. Furthermore the Court held that the concept of establishment involves the actual pursuit of economic activities through a fixed establishment for an indefinite period and the registration *per se* did not necessarily suffice for the definition of establishment.

The conclusions to be drawn from the *Quota Hopping* cases are lucid. First, the right of establishment entails a prohibition against discrimination in the host state, whatever the national rules are overtly or covertly discriminatory. Moreover, the Court's refusal to consider the national demand on management and operation in the *Quota Hopping* cases as incompatible with Art. 43 envisages that the provision does not grant protection exceeding a prohibition against discrimination.[40] Secondly, the concept of establishment refers to the pursuit of economic activities from a relatively fixed establishment through an indefinite period.[41]

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39 Cases C-3/87 *R. v. Ministry of Agriculture, Fisheries and Food ex parte Agegate* [1989] E.C.R. 4459 and 216/87 *R. v. Ministry of Agriculture, Fisheries and Food, ex parte Jaderow Ltd. [1989] E.C.R.* 4509.

40 This is one of the most fundamental differences between the right of establishment and the freedom to provide services. The latter freedom will be considered below in subsection 3.1.5.

41 In case the pursuit of the economic activity is carried on a temporary basis then the freedom to provide services applies rather than the right of establishment. On the distinction between the right of establishment and the freedom to provide services see the Court's reasoning in case 196/87 *Steymann* [1988] E.C.R. 6159 (in particular paras 16-17 and the *German Insurance* case (case 205/84 *Commission v. Germany* [1986] E.C.R. 3755, in particular at para 21.) The distinction between services and establishment is analyzed e.g. by Runge Nielsen, supra note 16 p. 84 *et seq*.

3.1.3 The Right of Establishment in the ISD

The wording of the relevant recital of preamble, as cited in on of the foregoing subsections[42] shows that the scope of establishment is limited to concern merely *secondary establishment,* and is even more limited since the Directive covers merely the establishment of branches. This means in practice that not only agencies but most notably also subsidiaries are excluded from the ambit.[43]

It may be questioned whether this approach is in entire accordance with Art. 43 EC and more particularly with the Court's case-law. It is well established that the right of secondary establishment according to the Treaty includes the right to set up agencies, subsidiaries and branches. Moreover, in a judgement, commonly known as the *French Tax Credit Case*[44] is it held, that is it contrary to the Treaty to discriminate against the various forms of secondary establishment.

> The factual background of the dispute concerns French tax legislation which granted tax deductions to recipients of dividends from companies established within France. The legislation prescribed that the benefit was available for persons who had their habitual residence or registered office within France. Thus, the practical effect of the legislation was that subsidiaries of foreign companies were to benefit from the advantage whereas branches and agencies established in France by them were excluded. The possible breach of Community law concerned therefore discrimination against branches and agencies, that is to say, an indirect discriminations against particular methods of secondary establishment. The Court held that "the right of companies (...) to pursue their activities in the Member State concerned through a branch or agency. Acceptance of the position that the Member States in which a company seeks to establish itself may freely apply to it a different treatment solely by reason of the fact that its registered office is situated in another Member State (...) would deprive [Art. 43 EC] of all meaning."[45] The Court subsequently made the position more clear in a subsequent paragraph by stating that "the second sentence of [Art. 43(1) EC] expressly leaves traders free to choose the appropriate legal form in which to pursue their activities (...) and that freedom must not be limited by discriminatory tax provisions."[46]

It may be suggested, that the approach adopted in the ISD does not constitute a violation of the Treaty, even though it admittedly is difficult to reconcile the approach of the ISD with the above mentioned judgement. First of all, it appears hard to appreciate how subsidiaries should be included in the ISD. It follows from the very definition of a branch, that it must be legally dependent part of an

42 See above in subsection 3.1.1.

43 In the systematic approach of both the SBD and the ISD the establishment of a subsidiary is considered as the establishment of a new credit institution or investment firm. A subsidiary will thus not be able to rely upon the principle of mutual recognition and home country control, but will get its own rights in accordance with the legislation in force in the state where the establishment of the subsidiary is effected.

44 Case 270/83 *Commission v. France* [1986] E.C.R. 273. See also case C-311/97 *royal Bank of Scotland*, judgment of 29 April 1999, not yet reported at the time of writing.

45 Para 18 of the judgment.

46 Para 22 of the judgment.

undertaking, and does therefore not possess legal personality.[47] The existence of a branch is thus dependent upon the parent undertaking. If for example the competent authorities of the home state withdraws an authorization from an investment firm to perform investment services, it follows that also the branch will no longer be entitled to carry on activities. In other words, a branch owes its existence to the parent body, and cannot be separated from it.

The position is entirely different with respect to subsidiaries. They are in all the national legal systems of the Member States considered as legally independent entities.[48]

Should the ISD include also subsidiaries within its ambit, it would accordingly imply that the legal separation between the parent body and the subsidiary should be penetrated. It may therefore be suggested that, despite the unambiguous wording of the Court's judgement in the *French Tax Credit* case, it is not legally possible nor desirable that the ISD include also subsidiaries of investment firms.[49] Thus, the solution adopted by the ISD appears to be in accordance of the legal approach of the Treaty.

It may even be argued that the solution adopted by the ISD, and the Second Banking Directive for that matter, could not be carried out in practise, if subsidiaries should be included in the scope of the Directives. It will be appreciated below, that one of bearing pillars of the ISD is the principle of mutual recognition and home country control.[50] This principle implies that an authorization granted by the competent authorities of the home state shall be mutually recognised throughout the Community, provided that the activities are carried out either via a secondary establishment in the form of a branch or by means of the provision of services. Thus, the ISD equalises the establishment of a branch with the provision of services. According to the present structure of the company law in the Member States where subsidiaries are considered as a legal entity independent from the parent body. Consequently, it remains hard to see how the exclusion of subsidiaries from the ambit of the ISD should contravene Community law.

The controversy regarding the exclusion of subsidiaries is partly due to a rather unfortunate drafting of the Treaty. According to Art. 43(1) prescribes that the right

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47 The definition of a branch is contained in Art. 1(8) as "a place of business which is a part of an investment firm, which has no legal personality and which provides investment services for which the investment firm has been authorized." In case an investment firm has more than one place of business in the host state, the ISD prescribes that "all the places of business set up in the same Member State by an investment firm with headquarters in another Member State shall be regarded as a single branch."

48 See generally on the legal position of subsidiaries in the national legal systems in the Community, Aalders and others; Branches and subsidiaries in the European Common Market. The exclusion of subsidiaries is not a problem isolated to the ISD. The same approach is adopted in e.g. the Second Banking Directive. On this aspect see generally Runge Nielsen; supra note 16 p. 221 *et seq*.

49 For a contrary view see van Gerven in [1990] *Yearbook of European Law* p. 61 - 62. The discussion is fostered by the fact that the Treaty mentions the establishment of subsidiaries on equal footing with the establishment of branches and agencies, see above in subsection 3.1.2.1. However, there are legal differences between branches and subsidiaries which justify a different treatment of these means of secondary establishment, see Runge Nielsen supra note 16, p. 141 *et seq*.

50 This aspect is discussed in detail below in subsection 3.4.

of establishment includes the right to set up "agencies, branches or subsidiaries." However, considering that the establishment of a subsidiary involves the *creation of a new legal entity* in another Member State, it appears at least arguable that the exercise of this particular right should be regarded as a form of primary establishment rather than one of secondary establishment.[51]

The remaining question is then whether the Court's judgement in the *French Tax Credit* case is wrongfooted. It is submitted that this is not so. In this case the Court explained that there was no legitimate reason to treat branches differently from subsidiaries. The wording of the judgement more than indicates that the Court was prepared to accept justifiable restrictions on the free choice between the various forms of secondary establishments.[52] Thus, in the present situation, where there are justifiable reasons for treating subsidiaries differently from branches, is it submitted that there exist no contradiction between the Court's case-law and the ISD.

With particular regard to *primary establishment* it should be noticed that the ISD does not concern this right at all. Also this is a consequence of the legal approach adopted in the Directive. It might be argued that the ISD is more concerned with the regulation of already existing undertakings rather than establishing rules relating to how new entities are created. However, there are a few provisions, which relates to this situation.

First, the ISD imposes an unconditional obligation that all undertakings carrying out investment services must be in possession of an authorization.[53] It is a specific requirement that the authorization shall designate the activities an investment firm is entitled to provide. This requirement is a necessary prerequisite for the legal approach of mutual recognition and home country control.[54] Secondly, the Member States shall require that, in case the investment firm is a legal person, that the registered office and head office shall be situated in the same Member State, and that the registered office shall be situated within the Member State that has granted authorization to the investment firm.[55]

This appears to be a limitation of Art. 58 EC which expressly prescribes that the right of establishment shall apply to "Companies and firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community shall, for the purposes of [the Treaty], be treated in the same way as natural persons who are nationals of Member States." Thus, the right of establishment is by means of this provision extended to cover legal persons which fulfil one of the formal requirements mentioned in the provision.

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51 See for more arguments; Runge Nielsen, supra note 16, p. 221 *et seq.*

52 See for a similar understanding of the judgment Marenco in [1991*] Yearbook of European Law* 111 at 114. See however for a contrary view Van Gerven in the same periodical [1990] 57 at 61-62.

53 Art. 3(1), first sentence of the ISD prescribes that "Each Member State shall make access to the business of investment firms subject to authorization for investment firms of which it is the home Member State."

54 The principle on home country control is dealt with below in subsection 3.4. See also in subsection 3.5. for observations on the list of activities.

55 Art. 3(2) of the ISD.

> It appears inappropriate, in the present context, to go into a more detailed analysis regarding this particular problem, which related to the international private law. Art. 58 EC is drafted so that it recognises both main streams in the international private law of the Member States. The majority of the Member States adhere to the *real seat* doctrine, whereas the minority accepts the doctrine of *incorporation*.[56] According to the approach of the real seat doctrine, the law of the country where the decisions are taken shall apply to the company. This means, that if a company is incorporated in accordance with the legislation of Member State A, but its real seat is situated in Member State B, the law of Member State B apply rather than that of Member State A. The practical consequence of this approach may be in the extreme, that a company will be faced with the legal death in case it transfers its real seat outside the state where is was incorporated. This is because that the legal form adopted in Member State one will be different from that known in Member State B.
>
> The incorporation theory is a more flexible approach. According this doctrine, a company remains governed by the law of incorporation, regardless of the situation of the real seat.[57]
>
> Art. 58 of the Treaty is worded in order to accommodate both main streams of private international law and makes thus no preference to either of the theories. The problem relating to the irreconcilability of these theories was by the authors of the Treaty thought solved by means of a convention on the retention of legal personality in case of transfer of the seat from one Member State to another.[58]

The solution adopted in the ISD, and in the Second Banking Directive for that matter, resembles an adherence to the doctrine of the real seat due to the requirement that the head office shall be situated within the same Member State as the state where the registered office is situated. Owing to the wording of Art. 58 EC, one might therefore question the compatibility of Art. 3(2) of the ISD with the Treaty. When the Treaty expressly recognises legal persons with either the registered office or the “real seat” situated in a Member State on equal footing with legal persons with only *one* of the connecting factors to the legal system of a Member State, it would have been at least desirable if the ISD had followed the legal approach of the Treaty. It must be admitted that there are legal implications which justify that the ISD departs from the Treaty. It is indicated in the Preamble of the ISD that the principles of mutual recognition and home country control imply this approach. Art. 1(6) defines the home Member State of an investment firm as the state where the undertaking has its registered office or if the legal person according to national legislation has no registered office, where the head office is

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56 The incorporation theory prevails in the United Kingdom, the Netherlands, Ireland and Denmark, cf. Cath in [1986] YEL 249 and Charny in [1991] Harvard International law Journal p. 429. The real seat theory is, with some variations employed in the rest of the Member States.

57 This is expressed rather picturesque by Lord Wright in *Lazard Brothers & Co v. Midland Bank Ltd*. [1933] AC 289 at 297: “English courts have long since recognized as juristic persons, corporations established by foreign law in virtue of the fact of their creation and continuance under and by that law (...) But if the creation depends on the act of the foreign state which created them, the annulment of the act of creation by the same power will involve the dissolution and non-existence of the corporation in the eye of English law. The will of the sovereign power which created it can also destroy it.”

58 See expressly Art. 220 of the Treaty. So far no negotiations on this subject matter has been initiated.

situated. The requirement in Art. 3(2) that the registered office and the head office must be situated in the same Member State is thus inserted partly to avoid confusion with respect to which Member State is actually the home Member State responsible for the granting of authorization and supervision of the undertakings.

In spite of the limited scope of secondary establishment and the apparent limitation of primary establishment, it can arguable be concluded that the ISD on the whole is in accordance with the Treaty provisions on establishment. It is however regrettable, albeit arguably legally justifiable, that the ISD on the substantial point regarding primary establishment of companies, does not follow the pattern of the Treaty. The legal theory was arguable much better off, if the ISD had stated the reasons which according to the Community legislator's view, justified the derogation from the Treaty.

3.1.4 The Provision of Services

3.1.4.1 The Provision of Services in Community Law

The freedom to provide services is enshrined in Art. 49 EC. The provision holds that "(...) restrictions on freedom to provide services within the Community shall be (...) abolished (...) in respect of nationals of Member States who are established in a State of the Community other than that of the person for whom the services are intended."

The subsequent provision, Art. 50(1) EC, contains a definition of the concept of services which in essence is an activity normally provided for remuneration. However, the Court's case-law shows that the concept of services does not differ from the activities which are carried out in accordance with the right of establishment. This is to say that the right of establishment and the freedom to provide services cover basically the same activities; what differs between these two rights are the duration of the presence in the host state.[59] If the presence is of temporary character then Art. 49 EC applies rather than Art. 43 EC on the right of establishment.[60]

The distinction between establishment and services is not merely an academic discussion. It was evidenced in one of the preceding subsections[61] that the right of establishment protects against discrimination in the host state. As will be shown in the following subsection the Court's case-law delivered under Art. 49 EC shows that the protection according to this article goes much beyond a prohibition against discrimination. Accordingly, undertakings whose activities fall under art. 49, are

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59 This is implied in several judgments, see e.g. *Steymann* supra note 41 and the *German Insurance* case, ibid. See also Steiner; Textbook on EEC Law (1993) p. 205.

60 That the temporary presence might be for a considerable length of time is illustrated in case C-113/89 *Rush Portuguesa Lda. v. Office National d'Immigration* [1990] E.C.R. I-1417. The case involved a portuguese contractor engaged who brought his own work force with him into France in order to fulfil his contractual obligations within the host state. It was ruled in this case, that the freedom to provide services included the right to bring along the domestic work force for the sole purpose of carrying out the contract.

61 See above in subsection 3.1.2.2.

secured a much larger degree of commercial freedom than would be the case if the activities was carried out in accordance with Art. 43 EC.

3.1.4.2 The Concept of Services

The importance of the prerequisite regarding economic activities have been it issue before the Court. In one case, *Humbel*[62] argued the plaintiff that only services which were available free of charge were to be excluded from the scope of Art. 49. The activity involved in the dispute concerned education at a technical college in Belgium. The educational establishment involved in the dispute was a state institute for general and technical education and was thus a part of the national educational system. The education was available free of charge for national students while a fee was charged foreign students. The Court ruled that the activity in question was not to be considered as a service within the meaning of Art. 49 EC. considering that education forms a integral part of the state's (social) obligations towards its citizens. Thus, despite the fact that an enrolment fee was normally charged foreign students, national public education did not constitute a service within the meaning of Art. 49 EC.[63]

It seems to follow from the wording of Art. 49 EC, that there must be a physical division between the provider of the service and the recipient. However, this does not necessarily imply that both persons can not be present in the same state. This is implied in Art. 50(3) which states that "the person providing a service may, in order to do so, temporarily pursue his activity in the State where the service is provided, under the same conditions as are imposed by that state on its own nationals." Thus, the thin borderline between the right of establishment and the freedom to provide services is not whether the presence of the provider; it is the length of the actual presence which are of importance.[64]

It was emphasised above in the subsection on the right of establishment that this freedom does not go further that securing the right to non-discriminatory treatment in the host state. An analysis of the existing case-law on Art. 49 EC shows that this Treaty provision is not limited to prohibiting discrimination. This feature was present already in the Court's early case-law,[65] and is refined beyond any doubt in the latest judgements. The line of cases, commonly known as the *Tourist Guide*[66] cases are illustrative for the scope of Art. 49. The national legislation prescribed that, in order to provide services as tourist guides within France, the guides should

62 Case 263/86 *Belgian State v. Rene Humbel and Marie-Thérèse Edel, [1988] E.C.R.* 5365.

63 It might be worth emphasizing that the outcome of the dispute would arguably have been different in case the educational establishment in question did not constitute a public education financed by the taxpayers see Runge Nielsen, supra note 16, p. 96.

64 For an example on the right of temporary presence in the host state *Rush Portuguesa*, supra note 60.

65 See e.g. case 33/73 *Van Binsbergen v Bestuur van de Bedrijfsvereniging voor de Metaalnijverheid* [1974] E.C.R. 1299.

66 The *Tourist Guide* cases consist of three judgments which were delivered at the same day; cases C-154/89 *Commission v. France* [1991] E.C.R. I-659, C-180/89 *Commission v. Italy* [1991] E.C.R. I-709 and C-198/89 *Commission v. Greece [1991] E.C.R.* I-735. The observations in the text concern merely the case against France since all cases concern identical points of law.

be in possession of a license issued by the French authorities in order to conduct guided tours, *inter alia* in public thoroughfares, museums and historical monuments. Such license was generally obtained by passing an examination in the candidate's own native tongue. If Art. 49 EC only protected against discrimination, the national legislation would arguably have been in accordance with Community law. However, the court held that *restrictions* on the free exchange of services were compatible with the Treaty only if "it is established that with regard to the activity in question there are overriding reasons to the public interest which justify restrictions (on Art. 49 EC.), that the public interest is not already protected by the rules of the state of establishment and that the same result cannot be obtained by less restrictive rules."[67]

The essence of the content of the *Tourist Guide* cases is that any national requirement which might constitute an impediment to the free provision of services is contrary to the Treaty. On the other hand, if there is a restriction, and that restriction is necessary in order to observe an interest worthy of protection in the host state, then the national legislation may be upheld, provided that the national legislation is no more restrictive that required for the protection of the interest in question. In the *Tourist Guide* cases, the Court recognised that there was a national interest worthy of protection[68] but it refused to accept that the same objective could not be obtained by less restrictive means.

The difference between the right of establishment and the freedom to provide services with respect to the scope of protection provided for reflects the sharp differences between these fundamental freedoms. The right of establishment entails an integration into the economy of the host state. This fact seems from a political point of view to justify that the protection in this case is limited to the prohibition against discrimination. This is not the case with the freedom to provide services. Under the exercise of this freedom, the provider of the service is, in general, separated from the host state, which is the target for his economic activities. Thus, it appears justifiable that the freedom to provide services entails a larger degree of freedom in comparison with the right of establishment. If the provider were to comply with all the requirements relating to the pursuit of a particular activity, the free provision of services would be hard to carry out in practice. In this case the provider would have to comply with two sets of rules, those of the home state where he might me educated and authorized and those of the host state(s) where he occasionally performs economic activities. It is therefore a necessary prerequisite to the provision of services that the host state can not impose its own rules upon the provider as the Court has repeatedly held in its case-law.

3.1.5 The Freedom to Provide Services in the ISD

With regard to the second foundation of the ISD, i.e. the freedom to provide services, the Directive appears, to a certain extent, to apply the approach of the Treaty. Art. 18 of the ISD merely prescribes that in case the investment firm

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67 The *French Tourist Guide* case, para 17.

68 In casu the proper appreciation of places and things of historical interest and the widest possible dissemination of knowledge of the artistic and cultural heritage of a Member State, see para 17 of the *French Tourist Guide* case.

intends to carry on services in the host state, it shall "communicate" some information to the competent authorities of the *home* state.

Art. 18(1) requires the undertaking to file information to the competent authorities concerning the operations stating in particular the investment services it intends to provide. It is thereafter the obligation of the competent authorities of the home state to communicate this information further to the competent authorities of the *host* state (Art. 18(2) of the ISD). It is not entirely clear from which time the investment firm may commence its activities in the host state. The provision of the ISD prescribes that "the investment firm may then start to provide the investment service or services in question in the host Member State." A literal interpretation of the provision could lead to the assumption that the investment firm not is entitled to commence its activities until the competent authorities actually has filed its information to the authorities of the host state. Another possibility is to construe the provision so that the lack of activities of the home Member State does not deprive the investment firm of the rights granted by the ISD. It is respectfully suggested, that the latter solution is to be preferred. In case the competent authorities do not comply with their obligations arising from the ISD, it appears, from a political point of view, more appropriate to let the authorities bear the responsibility for their own default, rather than the investment firm. What ever the legal solution on this problem may be, it appears that the provision is drafted rather unfortunate.

It is advisable, that the communication of the investment firm is formulated as broadly as possible; due to the approach of mutual recognition the host Member State is legally obliged to accept the provision of any investment services within its territories, *always provided that the undertaking is authorised to perform the activity, and provided that the activity in question is included in the list of activities*.[69] In case the communication to the competent authorities only includes some of the activities to which an investment firm is authorised to carry on, it shall go through another notification procedure (according to Art. 18(3) which may cause additional delay.[70]

It deserves to be noticed that the ISD merely includes the right for investment firms to provide investment services where only the service is "performing" the border crossing element. The two other means of providing services according to Art. 49 EEC,[71] are thus not covered.[72]

69 This point is analyzed below in subsections 3.4. and 3.5.

70 It may be argued that the notification procedure is a restriction which is incompatible with Art. 59 EEC. While there is no doubt that the requirement contained in the ISD is to be considered a restriction within the meaning of Art. 59, there seems to be no it might be argued that the restriction is justifiable for reasons concerning the supervision of investment firms. However, it must be admitted that it remains hard to the real purpose behind the rule, considering that the undertaking of investment services is now harmonized at Community level, and the investors and the market should therefore be sufficiently secured. On a discussion for the related problem within the sphere of credit institutions under the Second Banking Directive see Runge Nielsen, supra note 16 p. 208 *et seq.*

71 The first case is where the provider of the service enters into another Member State with a view to provide the service there, see Art. 60(3) EC and case C-113/89 *Rush Portuguesa Lda. v. Office national d'immigration* [1990] E.C.R. I-1417. The second case is where the recipient of the service enters another Member State with a view to receive the service within that state. The latter right is derived from the Court's case-law in joined cases 286/82 and 26/83 *Luisi and Carbone v. Ministero del Tesoro* [1984] E.C.R. 377.

3.2 The Requirement on Authorization and the Concept of the Grandfathered Rights

As pointed out above, the ISD obliges the Member States to make the access to the business of investment services subject to authorization. It should be noticed *in limine*, that the ISD does not require the Member States to authorise investment firms which already provides investment services. It is stated in one of the final provisions of the Directive, Art 30(1), that investment firms already authorised by the home state before the 31 December 1995, "shall be deemed to be so authorized for the purpose of this Directive."

Furthermore, according to Art. 30(2), investment firms which "already are carrying on business" on the same date, but have no authorization,[73] "may continue their activities provided that (...) they obtain authorization to continue such activities in accordance with the provisions adopted in implementation of this Directive." The provision set out a time limit, i.e. 31 December 1996[74] before which all investment firms must be authorized in accordance with Art. 3 of the ISD.

It is a precondition for relying upon the grandfathered rights in Art. 30(1) of the ISD that "the laws of those Member States provide that to take up such activities they must comply with the conditions equivalent to those imposed by Arts. 3(3) and 4 of the ISD. These provisions concerns the conditions which must be met, before the competent authorities may bestow[75] authorization.

It lies within these requirements that grandfathering cannot apply in case an undertaking is authorized to act as an investment firm in a given Member State, but the authorization does not regulate the pursuit of all the activities an investment firm is entitled to carry on according to the national legislation.[76] The requirement contained in Art. 30(1) relating to "conditions equivalent" to those imposed by Arts. 3(3) and 4 of the ISD shall not be understood as the only condition the national legal systems must comply with before an authorization granted before the

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72 It follows directly from the Art. 60(2) EC that also the right to pursue activities in the host state on a temporary basis. Secondly, it is well established in the Court's case-law that also the right to enter another Member State, with a view to receive services within that state is included under the freedom to provide services (Joined cases 286/ 82 and 26/83 *Luisi and Carbone v. Ministero del Tesoro* [1984] E.C.R. 377. Whereas the latter aspect of the freedom to provide services appears hard to include in a legal act concerning the right of the undertakings, it could have been made clear, why the exercise of the former right is excluded from the scope of the Directive.

73 The reference to investment firms that have no authorization concerns only the legal systems where no prior authorization was necessary in order to carry on investment services. It follows conversely that investment firms which provided investment services without authorization, in a Member State where authorization as a matter of fact was a precondition, cannot rely upon this provision.

74 This means that the Member States have been admitted additionally 23 months from the date of implementation (31 January 1995, cf. Art. 31(1) of the ISD) to secure that all investment firms possess a valid authorization.

75 See below in subsection 3.3. on the conditions which shall be met before granting authorization.

76 See for a similar opinion Shea, supra note 24, p. 121.

implementation of the ISD. Thus, the concept of grandfathered rights has a very limited application within the scope of the ISD.

3.3 The Requirement of the ISD for Authorization

As mentioned in the preceding subsection, all investment firms must be governed by a valid authorization after the implementation of the ISD. [The systematic approach of the ISD is that an investment firm only needs one authorization in order to perform activities throughout the Community. The condition is however that the activities are carried out by means of either the provision of services or via a branch established in the host country. If an investment firm considers it fit to be established in the host country by means of a subsidiary, it requires a new authorization in the country where the subsidiary is intended established. This is a consequence of the limited scope of the ISD[77]

This requirement on authorization does not apply to credit institutions authorized under the Second Banking Directive to provide the investment services mentioned in the Annex to this act,[78] whereas in case the credit institution is *not* authorized to perform investment services, a new authorization is required.[79]

The rules on authorization of the ISD possess the character of minimum rules. This principle is contained in the Preamble of the ISD which states that Member States may "as a general rule, establish rules stricter than those laid down in this Directive, in particular as regards authorization conditions..."[80]

The practical consequence of this approach is that there will not be one set of rules, applicable throughout EC, which governs the conditions investment firms shall comply with before authorization can be granted by the national legal system. The ISD sets out the *minimum* requirements the national legal systems are obliged to impose. However, in case an investment firm intends to carry on activities within any other Member State, the principle of mutual recognition obliges the host state to *recognise* the authorization granted by the competent authorities of the home state, irrespective of whether the authorization in question actually meets the

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77 See above in subsection 3.1.3. for a discussion as to whether the scope of the ISD contravenes Community law.

78 This assumption is based upon the wording of Art. 2(1) which states that the ISD shall apply to investment firms exclusively. See also Gruson and Feuring, supra note 26 p. 32 - 33, and above in subsection 2.1. However, a credit institution would need an authorization in accordance with the ISD in case the national legal system does not permit credit institutions to carry on the investment services mentioned in the Annex of the Second Banking Directive.

79 This is a consequence of the regime of mutual recognition and home country control. The home state decides in reality the range of activities a credit institution is entitled to perform both internally and at Community scale. Thus, if the credit institution is not authorized to carry on certain activities, it follows that the undertaking can not perform them, even though they might be mentioned in the list of activities subject to mutual recognition. See below in subsection 3.4. for comments on the concept of mutual recognition and home country control and in subsection 3.5. on the list of activities.

80 27th recital of the Preamble of the ISD. This aspect is not repeated word by word in the ISD. Art 3(3) prescribes the minimum requirements which must be met before the competent authorities may grant authorization. The provision reads: "Without prejudice to other conditions of general application laid down by national law, the competent authorities shall not grant authorization unless (...)"

requirements in the legislation of the host state. The only requirement the host state can impose is that the authorization, granted by the home state authorities, meets the (minimum) conditions established by the ISD.[81]

Art. 3(1) of the ISD lays down the general rule, after which it is required that the competent authorities of the home state shall grant authorization. It prescribes that the authorization shall contain a specification with regard to “the investment services (...) of the Annex which the undertaking is authorized to provide.” It follows from the systematic approach of the ISD that the Member States *may* include other activities than those apparent from the list of activities. However, activities not included on the list will not be subject to mutual recognition outside the sate of authorization.

Apart form the preconditions mentioned above with respect to the situation of the registered and head office,[82] the ISD contains additional preconditions for obtaining authorization. Art. 3(3) of the ISD imposes the following minimum obligations on the competent authorities. First, it requires that an investment firm shall have sufficient initial capital in accordance with the Directive on Capital Adequacy.[83] Secondly, it requires that the persons who “effectively direct the business” are of “sufficiently good repute and are sufficiently experienced.” This test is commonly known as the fit and proper test. Thirdly, there must be at least two persons responsible for the direction of an investment firm.[84] Fourthly, the investment firm must file to the competent authorities “a programme of operations setting *inter alia* the types of business envisaged and the organisational structure of the investment firm concerned.”[85]

It appears evident that the “fit and proper test” possess the character of a legal standard. It will, as the basic rule, be left completely to the competent authorities of the home state to make the final assessment regarding the moral conduct of the persons directing the investment firm. The provisions therefore more resembles a recommendation rather than a legal obligation of the competent authorities. However, despite of the fact that the provision is vaguely drafted, it is nevertheless submitted that the requirements must refer to conduct related to the pursuit of the

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81 On the legal background of the concept of minimum harmonization in the field of financial services see the Commission’s White Paper from 1985 (Com(85) 310 final). the White Paper sets out the initiatives which must be launched before the internal market in a reality. (On the internal market see above in subsection 1.1.) The approach of minimum harmonization leads almost inevitably to the discussion on whether the Community’s involvement will entail a race for the bottom. On this particular problem see e.g. Bradley in Oxford Journal of Legal Studies p. 545, Siebert in “The completion of the Internal Market” p. 53, Reich in [1992] Common Market Law Review p. 861 and Bebchuk in [1992] Harvard Law Review 1437.

82 See above in subsection 3.1.2. on the right of primary establishment.

83 Directive 93/6/EEC, OJ 1993 L 141/1.

84 See on the background for this requirement (“the four eye principle”) Ashall, supra note 4, p. 96. The provision contains supplementary rules in case the investment firm is a natural person. This aspect will not be dwelled upon in the following, apart from mentioning that the result is a compromise between the fraction of the Council which insisted upon the “four eye principle” and the United Kingdom and Ireland who wanted a continuation of one-man investment firms, cf. Shea, supra note 24, p. 121.

85 Art 3(4) of the ISD. The usage of the phrasing *inter alia* envisages that the competent authorities may impose supplementary requirements relating to the same topics.

actual business. Thus, administrative sanctions that are unrelated to the pursuit of business ought not to have any influence upon the granting of authorization. For the sake of completeness it must be emphasised that the refusal of the competent authorities to grant authorization, or the withdrawal, must be subject to control my the courts in the home state. This is not explicitly mentioned in the ISD but follows from the Court's case-law relating to the general Treaty provisions that the Member States can not define concepts established in Community law unilaterally.[86]

The same considerations apply with respect to Art. 4(2) of the ISD which holds that the competent authorities shall not grant authorization if the competent authorities are not satisfied with the "suitability" of the shareholders and members of the investment firm.

Apart form these requirements, the ISD obliges the competent authorities not to grant authorization until they have been informed about the identity of the shareholders or members, that have qualifying holdings in the investment firm and the amounts of the holdings.[87]

It deserves to be repeated that the requirements in the Directive are not exhaustive since the Member States are entitled to impose additional conditions. Thus, the requirements mentioned in this subsection concern merely the absolute minimum set of rules which shall be complied with before an investment firm can be granted authorization. This approach has severe repercussions for undertakings from third countries, which consider establishing themselves within the Community.[88] It is a direct consequence of the requirement on authorization for

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86 See e.g. on the public policy exception contained in Art. 48 EC which empowers the Member States to invoke derogation from the principle of free movement of workers case 41/74 *Van Duyn v. Home Office* [1974] E.C.R. 1337 where the Court held that public policy was a Community concept which the Member States could not define unilaterally. It is implied in this statement that the administration of this concept is subjected to judicial control. The submission is based upon the legal systematic of the Treaty; the Treaty divides the competence between the national courts and the European Court in Art. 177 EC. According to this provision the European Court is only entitled to rule upon disputes before national courts, i.e. not the national (central) administration. It is in other words a necessary prerequisite for the determination of Community concepts that the national courts refer the matter before the European Court by virtue of Art. 177 EC. See also case 292/86 *Gullung v. Conseils des Ordres des Barreaus de Colmar et de Saverne* [1988] E.C.R. 111 in which the Court held that requirements which seeks to secure observance of "moral and ethical principles and disciplinary control of the activity (...) pursues an objective worthy of protection. As pointed out by Wyatt and Dashwood in European Community Law p. 287 rules that do not meet these criteria violates Community law.

87 A qualifying holding i defined in Art 1(10) as "any direct or indirect holding of an investment firm which represents 10% or more of the capital or the voting rights or which makes it possible to exercise a significant influence over the management of the investment firm which that holding subsists." The provision contains an additional rule relating to Art. 7 of Directive 88/667/EEC (OJ 1988 L 348/62).

88 The legal position if Investment firms from third countries (i.e. States that are not Members of the Community or States that are not parties to an association agreement with the Community) are only covered partly by the ISD (Art. 7). The legal approach follows that of the Second Banking Directive. The extensive legal debate that followed the adoption of the Second Banking Directive thus also applies to this aspect of the ISD. See for critical comments on the Community's usage of its exclusive competence towards third countries

investment firms that the most advisable procedure for undertakings from third countries, is to establish a subsidiary within one of the Member States, and apply for authorization there.[89] It may therefore be worth considering in which Member State authorization should be applied for. Due to the approach of mutual recognition, investment from third countries are strongly encouraged to establish an undertaking within the Member State which contains the most liberal rules or allows for the most extensive list of activities to be carried on by investment firms.

However, there are certain limits conferred upon the choice of legal regimes. The Preamble of the ISD contains a rule relating to so called regulatory arbitrage.[90] The relevant recital reads:

> "Whereas the principles of mutual recognition and of home Member State supervision require that the Member States' competent authorities should not grant or should withdraw authorization where factors such as the content of programs of operations, the geographical distribution or the activities actually carried on indicate clearly that an investment firm has opted for the legal system of one Member State for the purpose of evading the stricter standards in force in another Member State within the territory of which it intends to carry on or does carry on the greater part of its activities;"

In spite of this obligation is not repeated in the substantive provisions of the ISD, it is nevertheless submitted that is has legal force, and should therefore be complied with by the competent authorities.[91]

Whilst the legal background of the avoidance of regulatory arbitrage is assessable,[92] it is not entirely clear how the competent authorities are obliged to administer the obligation of the Preamble in practice. Construing the obligation literally, it is not sufficient for the competent authorities to establish that the activities of an investment firm is directed towards other countries than the home country. The Preamble qualifies the obligation further by stating that the investment firm has opted for the legal system within a particular Member State *because* of the laxity of the regulatory regime within that state. The competent authorities must then assess first the activities, either intentionally or actually, carried out, and then judge whether the host state(s)'s regulatory regime is less lax compared with that of the home state.

Magee [1989] Harward Business Review p. 78, Levitin in [1990] Harvard Int. L. J. 507 and Runge Nielsen, supra note 16, p. 280.

89 This is a consequence of the fact that the ISD grants rights to nationals of the Member States or companies and other legal entities under Art. 58 EC. Thus a company from a third country will not be entitled to rely upon the ISD, and have therefore no automatic rights to penetrate the European market.

90 4th recital, first part.

91 This seems also to be assumed by Dassesse in The Single Market and the Law of Banking p. 69 - 70.

92 It is well established in the Court's case-law, that the Treaty freedoms must not be used to evade or circumvent stricter standards in force in another Member State, see e.g. the following case-law relating to services; Case 33/74 *Van Binsbergen* [1974] E.C.R. 1299, case 295/94 *Commission v. Germany* (commonly known as the *German Insurance case*) [1986] E.C.R. 3755. A similar view seems also to be adopted within the sphere of free movement of goods, see e.g. case 229/83 *Leclerc* [1985] E.C.R. 1.

It can however be suggested with a reasonable degree of certainty, that the laxity of the regulatory regimes must refer to the standards relating to financial services in force in another state. Thus, in case an investment firm opts for the legal system in one particular Member State for tax reasons, authorization ought not be refused. Another example concerns the activities an investment firm is entitled to carry on according to its authorization. It would be contrary to the very idea behind the principle of mutual recognition if the competent authorities should refuse to grant authorization on the sole ground that other Member States permit fewer activities to be provided by investment firms. It is one of the bearing ideas behind the approach of mutual recognition, that the market forces shall produce a pressure against the regulatory authorities in the Member States with a view to obtain that all the activities listed in the Annex must be carried on by undertakings authorized within that state.[93] Thus, the evasion of stricter standards is suggested to refer issues relating to e.g. national rules of conduct, requirements as to initial capital and supervisory aspects.

3.4 The Concepts of Mutual Recognition and Home Country Control

It is a noticeable feature of the legislation adopted in the financial services sector, that they are all based upon the principles of *mutual recognition* and *home country control*.[94]

Even though the two concepts appear to be identical, it should be borne in mind that they covers two different aspects of Community Law. The *former* concept, mutual recognition refers to the obligation of a given Member State to recognise a product, a service or an authorization etc. The concept does not necessarily imply that the host state is deprived the right of the host state to carry out control with a product or an activity originating from another Member State. As examples on the obligation of mutual recognition can be mentioned the extensively litigated Treaty provision on the free movement of goods, commonly known as the *Cassis de Dijon* doctrine.[95]

It is noteworthy that the obligation to mutual recognition requires the Member States to recognise the laws, regulations and administrative practices of other

93 See on the likely pressure for regulatory convergence Key in [1989] Federal Reserve Bulletin p. 604.

94 The Second Banking Directive, the Third Non Life Insurance Directive and the ISD contains virtually identical introductions to the legal approach of the acts. The third recital of the ISD reads: “Whereas the approach adopted is to effect only the *essential harmonization* necessary and sufficient to secure the *mutual recognition* of authorization and of prudential supervision systems making possible the grant of a single authorization valid through the Community and the application of the principle of *home Member State supervision*;” Emphasis added. The fourth recital of the Second Banking Directive and the Third Non Life Insurance Directive contain an almost identical formulation.

95 Case 120/78 Rewe-Zentrale AG v. Bundesmonopolverwaltung für Brantwein [1979] E.C.R. 649. On the Cassis de Dijon doctrine in general see e.g. Usher in Green, Hartley and Usher; The Legal Foundations of the Single European Market p. 60 et seq, Kapteyn and Verloren van Themaat; Introduction to the Law of the European Communities p. 375 et seq and Wyatt and Dashwood; supra note 86 p. 208 et seq.

Member States as equivalent to their own.[96] Mutual recognition goes therefore well beyond the prohibition against discrimination, since according to the approach of mutual recognition, Member States in effect are obliged to offer treatment that is more favourable than that offered to national undertakings.

A necessary prerequisite to mutual recognition is that the national legal systems do not differ in substance. If this was not the case, mutual recognition would not work in practice. Legal acts which harmonise the essential features relating to the industry are accordingly imperative. The legal instruments adopted in the field of financial services envisage are thus not aiming at giving detailed rules on every aspect relating to financial service, but intends to harmonise at a minimum level the rules which are essential for the application of mutual recognition.[97]

The concept of *home country control* can be described as the third side in the triangle where mutual recognition and minimum harmonisation constitute the two remaining sides. The necessity of minimum harmonisation and mutual recognition in the field of home country control can arguably best be appreciated when a parallel is drawn back to the fundamental Treaty provisions on the freedom to provide services. In one of the cases, *The German Insurance* case,[98] one of the issues in dispute was whether Germany lawfully could require authorization by the competent German authorities and compliance with the national legislation as a precondition for access to the German market. In this case the Court held that due to the sensitive character of the particular service in question (i.e. insurance), the host state was entitled to protect its own nationals from particular services provided from other Member States.[99]

In casu the Court further held that the national requirement on authorization was justified on grounds of consumer protection. It explained that the insurance sector was a particular sensitive area from the point of view of the protection of the consumer both as a policyholder and as an insured person. This was so “in particular because of the specific nature of the service provided by the insurer, which is linked to future events, the occurrence of which (...) is uncertain at the time when the contract is concluded.”[100] The Court assessed that the existing harmonisation at Community level did not provide for a sufficiently high degree of protection since the existing Directives did not harmonise the technical reserves necessary in order to guarantee liabilities under contracts entered into. Accordingly, the host state was entitled to require compliance with the legislation in force with a view to protect the consumers within that state. Concerning the specific requirements contained in the national legislation on authorization, the Court held that this measure was the only efficient means of supervision, and was thus justified by Community law as it then stood. The Court added that when considering an application for authorization, the competent authorities should take into account the requirements already met in the home state of the insurance

96 See also Key, supra note 93, at p. 602.

97 This is expressly recognized in the Preamble of the ISD quoted above in footnote 94.

98 Supra note 92.

99 See for a more detailed analysis of the *Insurance cases* Edward in [1987] ELRev 231, Flynn [1988] ICLQ 155 and Hodgin in [1987] CMLRev 273.

100 The *German Insurance case* 30th para.

undertaking. That is to say, that the host state was not permitted to required duplication of the requirements imposed by the home state authorities.

The result in the *Insurance cases* shows the need for secondary Community legislation as a precondition for the functioning of the internal market in financial services. The requirement on authorization in each host state before providing services there, will almost inevitably make the provision of border crossing activities prohibitive. The practical impact of the Court's findings in the *Insurance cases* is in reality, that insurance services could not be subjected to the principle of home country control. The competent authorities of the host state was thus entitled to require some degree of control with the financial activities carried out within the boundaries of the host state.[101]

The major task for the Community legislation was therefore to find the areas where protection of the weaker party was imperative before trade in financial services could be liberalised.[102]

By invoking the principle of home country control, a fundamental impediment to provide border crossing activities has been removed. It is thus the competent authorities of the host state which is obliged to recognise the supervision carried out by the home state authorities. This fact does however not imply that the host state bears no responsibility towards the undertakings authorized in another Member State. The ISD contains rules on the division of competence between the home- and host state authorities. This particular aspect of the Directive will be subject to a separate examination below.

3.5 The List of Activities

In the preceding subsection the concept of mutual recognition and home country control was analysed. It was concluded that the legal effect of the concept is that the host state is obliged to recognise an authorization issued by the competent authorities of the home state of the investment firm. However, a necessary prerequisite for the proper functioning of mutual recognition and home country control is that it is stated in the authorization the range of activities an investment firm is entitled to carry out. One possible solution in the harmonisation process is to draw up a list of activities which all Community investment undertakings are entitled to carry out. Another extreme is to leave the question to be decided upon in the national legal systems.

The solution adopted by Community legislation is between the aforementioned extremes. The ISD contains a list of activities, but the Member States themselves decides which activities from the list investment firms may carry out. The principle of mutual recognition and home country control combined with the list of activities thus result in the following legal position: The home state of an investment firm

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101 It deserves to be mentioned that the Court did not accept a so called "double license requirement" that is to say a duplication of the requirements already met in the authorization in the home state. Thus, the host state should according to the Court's judgment take into account the requirements already met when granting authorization. On this aspect of the *Insurance case* see Runge Nielsen, supra note 16, p. 114.

102 See also Fitchew in Working Document; *The Internal Market for Financial Services* (ed; Castello-Branco and Pelkmans at p. 139.

(that is to say the state that has authorized the undertaking) decides the range of activities investment firms are entitled to carry out. Conditional upon the activities being included in the list of activities of the ISD, they may be performed throughout the Community. If an investment undertaking is authorized to perform activities that are not mentioned on the list of activities of the ISD, it follows that the undertaking is not entitled to rely upon the ISD, but can invoke the basic Treaty provisions on the right of establishment and the freedom to provide services.[103] It is also a consequence of the legal approach of the ISD that the *host state* is barred from denying investment firms from other Member States the right to carry out activities on their territories even though investment firms authorized in the host state may not carry on the activity.

As a consequence of the aforementioned considerations it follows that the concept of an investment service is closely related to the list of activities annexed to the ISD. This point is made clear by Art 1(1) of the ISD which prescribes that an "investment service shall mean any of the services listed in Section A of the Annex relating to any of the instruments listed in Section B of the Annex that are provided for a third party".

The Annex of the ISD is divided into three separate sections:

Section A

Services

1. (a) Reception and transmission, on behalf of investors, of orders in relation to one or more of the instruments listed in Section *B*.

(b) Execution of such orders other than for own account.

2. Dealing in any of the instruments listed in Section B for own account.

3. Managing portfolios of investments in accordance with mandates given by investors on a discriminatory client-by-client basis where such portfolios include one or more of the instruments listed in Section B.

4. Underwriting in respect of issues of any of the instruments listed in Section B and/or the placing of such issues.

Section B

Instruments

1. (a) Transferable securities.

(b) Units in collective investment undertakings.

2. Money-market instruments.

103 This is also expressly stated in the 28 recital of the preamble of the ISD which holds that "the carrying on of activities not covered by this Directive is governed by the general provisions of the Treaty on the right of establishment and the freeodm to provide services."

3. Financial-futures contracts, including equivalent cash-settled instruments.

4. Forward interest-rate agreements (FRAs).

5. Interest-rate, currency and equity swaps.

6. Options to acquire or dispose of any instruments falling within this section of the Annex, including equivalent cash-settled instruments. This category includes in particular options on currency and on interest rates.

Section C
Non-core services

1. Safekeeping and administration in relation to one or more of the instruments listed in Section B.

2. Safe custody services.

3. Granting credits or loans to an investor to allow him to carry out a transaction in one or more of the instruments listed in Section B, where the firm granting the credit or loan is involved in the transaction.

4. Advice to undertakings on capital structure, industrial strategy and related matters and advice and service relating to mergers and the purchase of undertakings.

5. Services related to underwriting.

6. Investment advice concerning one or more of the instruments listed in Section B.

7. Foreign-exchange services where these are connected with the provision of investment services.

It is a direct consequence of the composition of the list of activities that investment firms may provide the services mentioned in Section A of the Annex only if they relates to the *instruments*[104] listed in Section B. It follows also directly from the definition of investment services and investment firms that when such services are carried on by an undertaking, it will require authorization, also if the investment

104 It should be noticed that the preamble of the ISD contains a definition on some of the instruments is in paras 9-11 of the preamble of the ISD.

firm does not intend to provide the services in other Member States than that of authorization.[105]

It is required in Art. 3(1) of the ISD that the authorization shall specify “the investment services referred to in Section A of the Annex which the undertaking is authorized to provide.” It thus follows that it is left entirely to the national legal system to decide the range of activities an investment firm is entitled to perform both internally and abroad.

The consequence of this approach is that if in investment undertaking is authorized to carry on an activity which is not mentioned in the list of activities of the ISD, the undertaking will only be able to pursue this particular activity within the boundaries of the home state. Conversely, if authorized to perform an activity included on the list of activities, it follows that such activities may be carried out throughout the Community. The concept of the single passport includes thus only the activities mentioned in the ISD. This means in practice that investment undertakings of a home state may be faced with reverse discrimination. In brief, reverse discrimination occurs when undertakings from another Member State are placed in a more favourable position compared with the state’s “own” undertakings. In the case of the ISD, investment firms authorized by the home state authorities may be placed in a competitive disadvantage compared with undertakings from other Member States.

Section C of the Annex is titled “non-core services.” It is mentioned in Art. 3(1) *in fine* that the authorization granted to an investment firm also may cover one or more services of Section 3 of the Annex. It is further stated that authorization within the meaning of the ISD may in no case be granted for services covered only by this Section. It thus appears that the performance of exclusively these activities by any undertaking can not be subject to authorization under the ISD. This part of the Annex shall be read in conjunction with Art. 11(1) which states that “the Member States shall also apply these rules where appropriate to the non-core services listed in Section C of the Annex.”

The requirement on authorization of the ISD applies thus only to the activities mentioned in Section A provided that they are related to the instruments stipulated in Section B. Despite the wording of Art 3(1) which permits the Member States to let the authorization cover also non-core services, it is suggested that all investment firms authorized in accordance with the ISD, are not automatically entitled to perform the non-core services mentioned in Section C of the Annex. It is only in the case where the non-core service is ancillary to one of the investment services mentioned in Section A and carried out in relation to one of the instruments mentioned in section B, that an investment firm is entitled to rely upon Section C of the Annex.[106]

The suggestion is based on the actual wording of the introductory provisions of the ISD. First, Art 1(1) defines investment services as the services listed in Section A relating to the instruments in Section B of the Annex. Thus the activities mentioned in Section C are *not* to be considered as investment services for the purpose for the ISD. The fact that Art 3(1) expressly permits some of the activities

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105 See also Shea, supra note 24, p. 128.

106 See also Shea, supra note 24 p. 128.

mentioned in Section 3 to be included in the authorization, is supposed not to alter this position. The provision may therefore be construed so that the competent authorities *shall* designate the activities mentioned in Section 3 of the Annex if the investment firm shall be entitled to carry on these activities. This submission seems also to be supported by the prohibition against authorisations which exclusively covers activities mentioned in Section C.

It might be subject to some criticism that the ISD is not more express regarding the right of investment firms to provide the non-core services mentioned in Section C. It appears confusing that the Directive first defines investment services as relating only to the services mentioned in Sections A and B and thereafter designating Section C activities as non-core services. It would have been better if the Directive at least had stated which non-core services which are most closely related to the investment services mentioned in Section A of the Annex.

4 The Prudential Supervision of Investment Firms

Prudential supervision of an investment firm is, by virtue of the principle of home country control, a matter for the competent authorities of the home state. Expressed in other words, the competent authorities, which granted authorization to an investment firm, shall also be responsible for the prudential supervision. This principle is envisaged in Art. 8(3) of the ISD which prescribes that the "prudential supervision of an investment firm shall be the responsibility of the competent authorities of the home Member State whether the investment firm establishes a branch or provides services in another Member State or not, without prejudice to those provisions (...) which give responsibility to the authorities of the host Member State."

Art 8(3) provides for a division of competence between the home and host state authorities. However, as it will be appreciated below, the division of powers is not a clear cut, but is blurred by the ambiguity of some of the substantial provisions of the ISD.

4.1 Art 10 (Prudential Rules)[107]

Art. 10 of the ISD requires the *home* Member State to "draw up prudential rules which investment firms shall observe at all times." The prudential rules shall "in particular" require the investment firms to:

> "have sound administrative and accounting procedures, control and safeguard arrangements for electronic data processing, and adequate internal control mechanisms including, in particular, rules for personal transactions by its employees,
>
> make adequate arrangements for instruments belonging to investors with a view to safeguarding the latter's ownership rights, especially in the event of the investment firm's instruments for its own accounts except with the investors express consent,

[107] This provision apply both to credit institutions and investment firms by virtue of Art. 2(1) of the ISD.

> make adequate arrangements for funds belonging to investors with a view to safeguarding the latter's right and, except in the case of credit institutions, preventing the investment firm's using investors' funds for its own account,
>
> arrange for records to be kept of transactions executed which shall at least be sufficient to enable the home Member State's authorities to monitor compliance with the prudential rules which they are responsible for applying; such records shall be retained for periods to be laid down by the competent authorities,
>
> be structured and organised in such a way as to minimise the risk of clients' interest being prejudiced by conflicts of interest between the firm and its clients or between one of its clients and another. Nevertheless, where a branch is set up the organisational arrangements may not conflict with the rules of conduct laid down by the host Member State to cover conflict of interest."

By virtue of the principle of home country control, the national requirements on prudential rules for investment firms are left to the home Member State to decide upon. Thus, the first sentence of Art. 10 of the ISD shall be construed as meaning prudential rules which investment firms authorized by the competent authorities of the home state always shall observe.

This fact is also supported by the wording of Art. 8(3) of the ISD which prescribes that the prudential supervision of investment firms shall be the responsible of the home Member State. It appears therefore more than appropriate to assume that the competence to lay down the prudential rules should be entrusted the legal system that have the responsibility for the supervision. It is in other words the designation of "home Member State" which is of crucial importance when determining the scope of the provision.

From the outset it can be appreciated that the division of competence between the host state and the home state authorities is far from being a clear cut. For example the last paragraph of Art. 10, concerning the conflicts of interests between the clients *vis-á-vis* the firm and other clients respectively.

In this case it is clear that the rules of the *home* Member State shall prevail over those of the host Member State by requiring that the rules of the home state may not conflict with the rules of conduct laid down by the host Member State. Before examining that potential conflict of competence it might be appropriate to examine the rules of conduct established by the ISD. This approach is chosen, since the competence to lay down rules of conduct arguable constitutes the outer limits of the host state's competence to regulate the provision of activities.

4.2 Art 11 (Rules of Conduct)[108]

Art. 11 of the ISD concerns the rules of conduct. The provision requires that

> "Member States shall draw up rules of conduct which investment firms shall observe at al times. Such rules must implement at least the principles set out in the following indents and must be applied in such a way as to take account of the professional nature of the person for whom the service is provided.

108 This provision apply both to credit institutions and investment firms by virtue of Art. 2(1) of the ISD.

The Member States shall also apply these rules where appropriate to the non-core services listed in Section C of the Annex. These principles shall ensure that an investment firm:

acts honestly and fairly in conducting its business activities in the best interests of its clients and the integrity of the market,

acts with due skill, care and diligence, in the best interests of its clients and the integrity of the market,

has and employs effectively the resources and procedures that are necessary for the proper performance of its business activities,

seeks from its clients information regarding their financial situations, investment experience and objectives as regards the services requested,

makes adequate disclosure of relevant material information in its dealings with its clients,

tries to avoid conflicts of interests and, when they cannot be avoided, ensures that its clients are fairly treated, and

complies with all regulatory requirements applicable to the conduct of its business activities so as to promote the best interests of its clients and the integrity of the market.

2. Without prejudice to any decisions to be taken in the context of the harmonisation of the rules of conduct, their implementation and the supervision of compliance with them shall remain the responsibility of the Member State in which a service is provided.

3. Where an investment firm executes an order, for the purposes of applying the rules referred to in paragraph 1 the professional nature of the investor shall be assessed with respect to the investor from whom the order originates, regardless of whether the order was placed directly by the investor himself or indirectly through an investment firm providing the service referred to in Section A(1)(a) of the Annex.[109]

As stated above, the rules contained in this provision shall apply to all investment firms in the Member State concerned irrespective of whether it is investment firms authorized within that state or it concerns investment firms from other Member States providing services in the host state.[110]

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109 It deserves to be noticed that Art. 11 virtually corresponds with the rules adopted by IOSCO (International Organization of Securities Commission.

110 Clarotti notices in EC Financial Market Regulation, at p. 9, that it is has been found to be “impracticable at the present time” to harmonize the rules relating to the conduct of business. This statement seems to suggest by implication that the Commission is aiming at suggesting rules which harmonize the rules of conduct in the future. This approach is, from a theoretical point of view, to be welcomed. One of the remaining obstacles to trade in financial services is the fact that the national markets are founded on different (legal and moral) traditions which might be difficult to comprehend before the penetration of the market in question has taken place. The lack of harmonization of these matters should therefore facilitate a more smooth functioning of the internal market. On the other hand, it remains an open question whether codes of conduct are suitable for harmonization.

The distinction between Arts. 10 and 11 reflects not only the division of legislative competence between the host- and home state. The distinction also sets the limits of the principle of mutual recognition. The codes of conduct is related to each particular Member State and is therefore not suitable to be subjected to harmonisation at Community level nor is the obligation of mutual recognition likely to work in practice.

It is apparent that most of the substantial rules in Art. 11 can be characterised as legal standards, which may well have a particular meaning in each Member State.[111] This applies for example with respect to the obligation to ”act with due skill, care and diligence” in the second subsection of Art. 11(1) and the obligation to disclose adequate material in its dealing with the clients of the investment firm in the 5th subsection of the provision. It is suggested that the level of comparison in this provision should be that of each particular Member State, rather than a lowest common denominator at Community level. This provision will therefore leave considerable scope for the national legal systems which are responsible for implementing it.

4.3 Possible Overlaps between Arts. 10 and 11 of the ISD

It is of fundamental importance to distinguish Arts. 10 and 11 of the ISD since these provisions mark the distinction between home- and host country supervision. However, as pointed out above, there seems to be considerable scope for overlaps between the provisions, which arguably will lead to uncertainty when implementing the provisions into national legislation.

All matters relating to accounting and the conduct of the employees regarding their personal transactions are the competence of the home Member State. Rules governing these matters are only mentioned in Art. 10 of the ISD and Art. 11 does not contain any rules governing these matters. Is it therefore submitted, that the host country is incompetent to issue legislation applicable to investment firms from other Member States regarding this subject matters.

The problems relating to the conduct of the employee entails the discussion relating to *insider dealing* although this subject matter is apparently not included explicitly in the scope of the provision. This is arguably due to the fact that the Council in 1989 adopted a Directive which harmonises the national legislations on insider dealing.[112] It falls beyond the purpose of this discussion to go into a detailed analysis of the content of the insider dealing directive. However, it might be mentioned that Art. 2 of this directive obliges the Member States to adopt rules prohibiting any person who have access to inside information by virtue of his employment to take advantage of that information or, according to Art. 3,

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111 It is not ignored, that the Court consistently has required that concepts contained in Community law shall have a Community meaning, and shall thus be construed after identical principles, see e.g. the judgment in case 53/81 *Levin v. Staatssecretaris van Justitie* [1982] E.C.R. 1035 on the concept of a worker according to Art. 48 EC. It is nevertheless suggested that legal standards may have a different *content* in the different Member States. Some of the requirements in Art. 11 of the ISD refers to matters which relates to the moral in the conduct of business, which is a concept there might be subject to a different understanding in the legal systems of the Member States.

112 See Council Directive 89/592/EEC, OJ 1989 L 334/30.

disclosing it to third parties. Thus, even though the rules of conduct are the competence of the host state, the existence of Community legislation equals that the substantive differences, regarding the issue of insider dealing, between the national legal systems remains limited.

However, ambiguities exist with respect to the protection of the interests of the clients due to the fact that both provisions contains rules governing this subject. Art. 10, third subsection lays down rules on the safeguarding of instruments belonging to the investor on which behalf the investment firm acts. Moreover, the last subsection of the provision holds that the investment firm shall be organised in such a way as to minimise the risk of the client's interests, but stipulates at the same time, that a branch[113] shall observe the rules of the host country with respect to conflict of interests. It is expressly held in Art. 11(1) 6th subsection, that it is the obligation of the host country to lay down rules with a view to prevent conflict of interests(!)

Art. 11 might in other matters be construing as to containing the same aspect as Art. 10 by virtue of the wording of several subsections of the provision. For example Art. 11(1), 7th recital holds that the national rules must ensure that investment firms comply with "regulatory requirements applicable to the conduct of its business activities so as to promote the best interests of its clients and the integrity of the market." Clearly a crucial component of the conduct of business activities *might* be the obligation to secure and protect the investors ownership, which according to Art. 10, 2nd recital is an obligation for the home country to legislate upon.

The blurred borderline between Arts. 10 and 11 of the ISD can be used as an illustration as to how difficult the distinction between the competence of the home state competence and that of the host state. It also envisages the practical need for further harmonisation to be adopted on the context of the rules of conduct, if the internal market for investment services shall be a reality. It is an essential feature of Community legislation that it is drafted rather vaguely and that it stipulates aims rather that clear and unambiguous obligations for the Member States. However, by adopting rules where not even the competence of the home and host Member State is clear, the Community legislator has not acted in the interest of European integration in financial services. Both legal writers and the practitioners in charge of implementing the ISD are faced with severe difficulties in the course of implementation. A likely consequence of the adopted solution in the ISD is that crucial matters are subjected to both home and host state regulation, a solution which hardly is in accordance with the aim of the ISD, i.e. to create the internal market in investment services.

It might be questioned whether the approach of minimum harmonisation regarding codes of conduct is a acceptable legislative technique in the field of

113 The actual wording of the provision must necessarily imply that an investment firm utilizing the freedom to provide services by virtue of the Directive, shall not observe the rules of the host state. Thus, the ISD distinguishes, in contrast to the Second Banking Directive, expressly between the exercise of the two rights. This is also the only difference between branching and the provision of services. For reasons mentioned above in subsection 3.1.2., subsidiaries shall always observe the rules of the country according to which law is it established, since the ISD rightly treats subsidiaries as a new entity, independent from the parent body.

financial services. It should be borne in mind that one of the core issues in the Court's judgement in the *German Insurance case*[114] concerned, *inter alia* the conflict between the competence of the home and host state authorities. It will be remembered that the Court expressly held that, due to the sensitivity of the activity in question, the host state was entitled to require compliance with its own rules on authorization.[115]

It is accordingly debatable whether the ISD alters the legal position according to the *German Insurance case* since it will be the competence of the host state authorities to regulate the code of conduct and conflicts of interests between the clients and the investment firm.[116]

5 Particular Remarks on the Regulated Markets

The concept of the regulated market was introduced during the last stage of the negotiations of the ISD.[117] The legal justification for including the concept of a regulated market into the ISD lies in the fact that trade in securities, bonds etc. takes place at the national stock exchanges. Therefore, the ISD would be rather incomplete if rules granting access to the markets for trade in securities were absent. In order to cover all the institutionalised markets where securities are being traded, the ISD does not designate exactly what national markets that are covered, but is confined to the concept of a regulated market.

5.1 Definition of a Regulated Market

A regulated market is defined in Art. 1 of the ISD as

> "a market for the instruments listed in Section B of the Annex which;
> - appears on the list provided for in Art 16 drawn up by the member State which is the home Member State is defined in Article 1(6)(c),
> - functions regularly
> - is characterised by the fact that regulations issued or approved by the competent authorities define the conditions for the operation of the market, the conditions for

114 Supra note 92.

115 See in particular paras 15 - 33 and 42 - 51.

116 It is significant to notice, that the remarks in the text does not concern the authorization requirement contained as the Court dealt with in the *German insurance case*. The ISD expressly prohibits the host state to require authorization before an investment firm commences activities either by the provision of services or the establishment of a branch, see Art. 14(1) which prescribes that the Member States shall ensure that investment services may be carried on either by the provision of services or through a branch. The subsequent subsection makes it quite clear what the content of these rights entails. It establishes that the host Member State may neither make the exercise of the aforementioned rights subject to any authorization nor to provide endowment capital or "to any other measure having equivalent effect."

117 Ferrarini, [1994] Common Market law Review 1283 at 1292.

access to the market and, where Directive 79/279/EEC[118] is applicable, the conditions governing admission to listing imposed in that Directive and, where that Directive is not applicable, the conditions that must be satisfied by a financial instrument before it can effectively be dealt in on the market,

- requires compliance with all the reporting and transparency requirements laid down pursuant to Articles 20 and 21.

The definition of a regulated market covers certainly the traditional national stock exchanges,[119] but it appears that the definition goes much beyond this concept. By virtue of Art. 15 of the ISD, host states are obliged to secure that investment firms from other Member States can "either directly or indirectly, become members or have access to the regulated markets" where the services mentioned in Section A(1)(b) and (2) of the Annex or similar services are provided. Thus, the London International Financial Futures Exchange (LIFFE) and the London Securities and Derivatives Exchange (OMLX) will arguably be governed by the definition.[120] Particular concern was raised during the negotiations on the London Stock Exchange's International Equity Market (SEAQ International). It appears that the implementing bodies in the United Kingdom will adopt rules which will enable this market to qualify for the definition of a regulated market within the meaning of the ISD.[121]

In this connection it is intriguing to observe that the Community Directive on Insider Dealing[122] also covers regulated markets. According to Art. 1 of the Insider Dealing Directive it covers dealing in transferable securities admitted to trading on a "market which is regulated and supervised by authorities recognised by public bodies, operates regularly and is accessible directly or indirectly to the public."

Even though the definition of the ISD on a regulated market appears far more detailed than that of the insider Dealing Directive, it is by no means certain that there are substantive differences between the concepts of a regulated market in the two Directives. The core of both definitions lies arguably in the requirement on a regular functioning, and supervision by a competent body. It appears thus of minor importance that the Insider Dealing Directive does not include an obligation relating to regulations issued or approved by the competent authorities.

118 OJ 1979 L 66/21. This Directive is commonly known as the Listing Particulars Directive. The directive lays down minimum standards of disclosure to be met by in listing particulars published on the occasion of securities being admitted to listing.

119 This submission is based upon the content of the Commission's original proposal (COM(88) 778 final), at p. 7 where it is stated that the single passport also shall cover the right of access to national stock exchanges and other organized markets. This rule was originally contained in Art. 10(4) of the proposal.

120 See for a similar view Whittaker in 1994 Journal of International Banking and Financial Law p. 380.

121 See Whittaker, ibid.

122 Council Directive 89/592/EEC, OJ 1989 L 334/30.

5.2 Substantial Obligations on Access to the Regulated Markets

5.2.1 Content of the Obligation

The essence of the obligation to secure access to the regulated markets is that if investment firms authorized in the home state are entitled to provide the services mentioned in section A(1)(b) and (2) on the national regulated markets, then investment firms from other Member States acting on that market, shall also be granted, if not membership then, access to such regulated markets.

The wording of the provision can lead to the conclusion that the host state is not obliged to secure membership of the regulated markets in the case where a genuine access is secured in other ways. However, according to another interpretation is it only necessary to let the foreign undertakings become members of the national regulated market where it is a precondition for conducting business there.

The preamble of the ISD might provide for an appropriate answer to this problem. It is held in the Preamble that "Member States shall ensure that (...) treatment of all investment firms (...)" and that "investment firms must all have the same opportunities of joining or having access to regulated markets."[123] Furthermore, the preceding subsection holds that "any reference (...) to *access* and *membership* of regulated markets should be read as including references to access to and membership of bodies performing clearing and settlement functions for regulated markets."[124]

When reading the substantive provisions of the ISD in conjunction with the rather explanatory recitals of the Preamble, it appears appropriate to conclude that where membership of the national markets is required according to national legislation, undertakings from other Member States shall be granted an identical right. It thus also follows that foreign undertakings must comply with the same obligations as those imposed upon domestic actors on the market.

Art 15 of the ISD is one of the provisions which, by virtue of the general cross reference in Art 2(1), second sentence, also applies to *credit institutions*. This may cause some practical implications in the Member States where credit institutions are statutorily barred from provide investment services.[125]

The Second Banking Directive contains a rule, in Art 18(2) according to which *subsidiaries* of credit institutions is entitled to rely upon the advantages of the single license, provided that certain requirements are met.[126] These entities are

123 36th recital of the ISD.

124 Emphasis added.

125 It might be noticed that in some Member States *credit institutions* constitutes a specific problem since membership of regulated markets is possible only be establishing a specialized subsidiary for that purpose. The Commission is, according to the 37th recital of the preamble, obliged to submit a report to the Council on the consequences of the obligation to let all credit institutions have access to the regulated markets in the Member States.

126 For a detailed survey of this aspect of the Second Banking Directive see e.g. Gruson and Feuring, supra note 26, p. 21.

designated as *financial institutions*[127] in the Second Banking Directive, and are thus *not* entitled to invoke Art. 15 of the ISD.

In case where credit institutions according to national legislation are barred from entering the national stock exchanges or other regulated markets, the ISD provides for a transitional period expiring December 31 1996.[128] It will be remembered from one of the preceding subsections[129] that the ISD is founded on the principle of mutual recognition and the single license. These principles implies that host states are bound to accept investment firms from other Member States provided that they are authorized in their home states to provide the services referred to in Art. 15 of the ISD, even though that undertakings authorized within that state are denied access to the regulated markets. The effect of the transitional period in Art. 15(2) is in effect that these Member States will, in their capacity as host states, be entitled to prevent credit institutions from other Member States access to their national regulated markets until the expiry of the transitional period.

Due to the different structure of the regulated markets in the various Member States, the Art 16 of ISD obliges the Member States to draw up a list of the regulated markets with a view to an annual publication in the Official Journal. The same provision prescribes that the Commission shall draw a report on in the information on the regulated markets received from the Member States, with a view to propose amendments to the definition of regulated markets.

Since the ISD contains a rather rigid definition on the concept of a regulated market, it might give rise to doubt how the competent authorities in any host state shall act with respect to markets for securities that fall outside the definition of the ISD.[130]

It must be admitted that Art. 15(1) of the ISD requires merely that the Member States shall grant access to their regulated markets. This could lead to the assumption that the Member States were entitled to exclude foreign undertakings from national markets which do not qualify for a regulated market. However, there are three strong arguments against this proposition.

First, it would be contrary to the basic concept of an internal market if the host state could deny access to such markets merely on grounds of the fact that it falls outside the scope of Art. 15. It is in this respect significant to notice that the first part of Art. 15(1) holds that the right of access to the national regulated markets shall be effected “without prejudice to the exercise of the right of establishment and the freedom to provide services” of Art. 14 of the ISD. It is thus required that the access to the regulated markets shall not prejudice the right the fundamental economic freedoms of the Treaty. The drafting of the provision thus suggests that it

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127 See Art. 1(6) of the Second Banking Directive for the exact definition of a financial institutions.

128 Art 15(3) *in fine*. A further transitional period is provided for Spain, Greece and Portugal lasting until December 1996. It is a precondition that the legislation prohibiting credit institutions access to the regulated markets should be in force at the time where the ISD was adopted.

129 See above in subsection 3.4.

130 Hereinafter a “non-regulated market.” The expression is used in order to designate that the market falls outside the definition of a regulated market as defined in the ISD. Accordingly, a non-regulated market is not necessarily a market which is not regulated at the national level albeit a market which is not regulated in the sense of the ISD.

is adopted as a precaution with a view to designate that the host state is barred from discriminating foreign undertakings. Thus, construed in this way, it appears inappropriate to make any "false" conclusions *a contario*, because nothing in the provision indicates that the purpose behind it, is to allow discrimination regarding access to non-regulated markets.

Secondly, when an investment firm is authorized to trade in investment services by their home state authorities, it appears hard to appreciate that the host state should be able to deny the undertaking access to a "non regulated market". It would appear contrary to the purpose behind the ISD. The harmonisation of the investment services business contained in the ISD and the related Directives[131] has as one of its primary purposes to establish the harmonisation "necessary and sufficient" to secure that the principle of mutual recognition can work in practice. Thus, when an investment firm is entitled to operate on the regulated markets by virtue of the principle of mutual recognition and the single license, it appears contradictory to claim that the harmonisation is insufficient for the purpose of the "non-regulated markets."

Thirdly, the Treaty's fundamental provisions on the right of establishment and the freedom to provide services applies to matters that are not governed by the ISD. This is follows to a certain extent from the Preamble of the ISD which states that

> "the carrying on of activities not covered by this Directive is governed by the general provisions of the Treaty on the right of establishment and the freedom to provide services."[132]

This seems to suggest by implication that in matters not governed by the ISD, the Member States are obliged to observe the Treaty's principle of non-discrimination and would indeed be the case, even if it was not the solution adopted by the ISD.[133] Whether the right of access to the non-regulated markets steams directly from the ISD or the Treaty itself remains as a question with little practical relevance. However, it is thought that the implementing bodies of the Member States would have been better off if the ISD had been more specific on this matter. The detailed definition of a regulated market in the ISD could lead to the (false) conclusion that "non-regulated markets" were not included amongst the markets where the host

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131 Most notably the Directive on Capital Adequacy, supra note 27, but also the Directive on Deposit guarantee schemes.

132 Arts. 43 and 59 of the Treaty respectively. This is also acknowledged implicitly in the Preamble of the ISD in the 28th recital which reads:

133 Both the right of establishment and the freedom to provide services have been directly applicable since the beginning of the 1970'ies, see case 2/74 *Reyners v. Belgium* [1974] E.C.R. 631 (the right of establishment) and case 33/74 *Van Binsbergen v. Bestuur van de Bedrijfsvereniging voor de Metaalnijverheid* [1974] E.C.R. 1299 (the free provision of services). However, by virtue of Art. 61(2) EC, the freedom to provide services were not applicable to the banking services connected with capital movements was not liberated before the free movement of capital was a reality. This exception may apply *a fortiori* to investment services involving capital movement across borders. Capital movements between Member States were fully liberalized by the adoption of the Second Capital Directive (Directive 88/361/EEC, OJ 1988 L 178/5). See also Runge Nielsen, supra note 16, p. 81.

state is obliged to secure an effective access. It is therefore respectfully suggested that, although the ISD does not expressly cover the "non-regulated markets", it ought to be construed with a view to secure that investment firms shall be entitled to operate on these markets. There seems to be very little legal justification for the opposite position.

5.2.2 Content of the Provision

Apart from the aforementioned obligations, art 15(1), second sentence, of the ISD requires that the Member States shall abolish national rules which limits the number of persons entitled to become members of the market. The rules is presumably enacted with a view to avoid circumvention in the national legal systems. By prohibiting national rules which, judged *prima facie*, are of a non-discriminatory nature, since they might constitute an impediment of access to the regulated markets, the legislator has made it clear that the right of access shall be unconditional.

Furthermore, it is prescribed in the following subsection of the provision, Art 15(2), that membership of the regulated markets shall be conditional upon an undertaking's compliance with capital adequacy requirements in accordance with the Capital Adequacy Directive.

It is thought that the right of access to the national regulated markets according to the ISD is of such clarity that legal disputes regarding this issue should be avoided. The only scope left for the national legal systems is stated in the last part of the subsection which adds that "host Member States shall be entitled to impose additional capital requirements only in respect of matters not covered by [the Capital Adequacy] Directive."

As a inevitable consequence of the approach adopted in the ISD, it is left for the national legal systems to lay down the rules governing the regulated markets. This appears in the ISD in the following way in Art. 15(2) last sentence:

> "Access to a regulated market (...) shall be subject to compliance with the rules of the regulated market in relation to the constitution and administration of the regulated market and to compliance with the rules relating to transactions on the market, with the professional standards imposed on staff operating on the market and with the rules and procedures for clearing and settlement."

For the sake of completeness it is held that the rules governing the national regulated market shall be non-discriminatory by a cross reference to Art. 28 of the ISD.

It is significant to notice that host Member States are according to Art. 15(3) of the ISD only obliged to grant access to the regulated markets for investment firms that already are established by means of a branch within the host state or by setting up subsidiaries.[134] Thus, this is one of the (few) occasions where the right of

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134 This is not entirely true. Art 15(3) contains an oddity according to which investment firms may obtain access to a regulated market by acquiring firms in the host state that are already members of the regulated market there. The necessity of this provision is debatable. It is presupposed in the provision by implication that the mere acquisition of an investment firm *could* entitle the host state to withdraw membership or deny access to the regulated market.

establishment is treated more favourably than the provision of services, since some degree of presence in the host state is required. However, in the case where of automated markets or markets where there is no requirement for a physical presence,[135] Art. 15(4) holds that investment firms are to be granted the right of access without any establishment in the host state.

6 Requirements relating to Transparency

6.1 General Requirements

The ISD contains a number of provisions regarding transparency of the regulated markets.[136] Art. 21 of the ISD requires the Member States to enact rules governing the investors ability to assess the conditions according to which a transaction has been carried out. The provision sets out the minimum requirements the competent authorities shall impose with regard to this subject matter for the markets referred to in Art. 16.[137]

Like other provisions of the ISD, Art. 21 does not lay down exact rules which the Member States must comply with. The provision contains minimum standards which Member States must observe at all times but it is left open for the Member States to enact legislation which goes beyond those of the Directive's.[138] It is merely required that the competent authorities of the home state shall determine the form and in which and the precise time within which the information is to be provided, as well as the means by which is it to be made available.[139]

However, the last sentence of Art. 21(2) permits the Member States to apply more flexible provisions for transactions concerning bonds and other forms of securitized debt "particularly as regards publication deadlines." This provision is arguably inserted with a view to avoid the problems, which may arise with respect to securities where the market in some cases is highly volatile, but it disturbs the intended clarity of the general transparency requirements of the ISD.

However, if this was the case, it would be a flagrant violation of Arts. 58 and 220 which equalize foreign investors with domestic ones. It remains therefore mysterious why it is regarded as a necessity to include the rule in the ISD. The rule is thought to be of very little relevance, and will accordingly be ignored in the following.

135 E.g. markets operating electronically, via screens, cf. She, supra note 24, at p. 132.

136 See on the initial difficulties in obtaining an agreement in the Council due to the different structures of the regulated markets in the Member States, Ashall, supra note 4, at p. 99.

137 This provision relates to the list Member States must draw of the regulated markets.

138 This follows explicitly from 27th. recital of the Preamble which prescribes that the Member States "may, as a general rule, establish rules stricter than those laid down in [the ISD], in particular as regards authorization conditions, prudential requirements and the rules of reporting and transparency." See also Art. 21(3) of the ISD which contains more detailed guidance.

139 The drafting of this particular requirement appears rather unfortunate. The actual wording of the provision could lead to the conclusion that the ISD prevents the national legislator to lay down the rules by requiring that the competent authorities shall determine the information to be provided. It is however suggested that the ISD does not prevent the national parliaments or governments to draw up the rules. What matters for the purpose of the ISD ought not to be the bodies competent to enact the rules but rather that the *content* of the legislation and the fact that the law is enforced.

6.2 Common Rules for all Regulated Markets

The content of the (minimum)-requirements in Art. 21 is rather complicated. First, it should be noticed that the obligations of the provision refers to *each of the instruments* mentioned in the Annex.[140] Secondly, the provision does not relate to each particular investment firm but to each particular regulated market. It is thus not the investment firms that are responsible for the publication of information but the responsible management of the regulated market. The provision obliges the competent authorities to "take measures to provide investors with the information" which again leaves a considerable scope for manoeuvre for the competent authorities. However, it clearly springs to mind, that the competent authorities are barred from publishing merely the price of e.g. particular securities on all regulated markets in the Member State as a whole.[141]

Art. 21(2)(a) states that the competent authorities shall require publication of the weighted average price, the highest and the lowest prices and the volume dealt in on the regulated market for the whole of the preceding day's trade. It is required that the investment firms publish the above-mentioned date at the beginning of each day's trading for each regulated market in question.

6.3 Special Rules for Continuous Order-driven and Quote-driven Markets

Art. 21(2)(b) adds for continuous order-driven and quote-driven markets more strict transparency requirements. At the end of *each hour's* trading on the market the weighted average price and the volume dealt in on *each particular* regulated market for a six hour trading period "so as to leave two hours' trading on the market before publication." The stipulation with regard to the two hours is assumed to allow two hours trade to pass before the publication shall take place.
Furthermore, every 20 minutes shall, for the same market, "the weighted average price and the highest and lowest prices on the regulated market in question for a two hour trading period" be published so as to leave one hour's trading on the market.

These requirements on transparency are likely to give rise to considerable implications in practice in the national legal systems. In particular the obligation relating to the order-driven and quote-driven markets appear problematic in implement in practice since it requires the competent authorities to provide for a continuous supervision on the commercial development on the regulated markets.

6.4 Rules where Investors have Prior Access to Price Information

A third category of rules on transparency concerns the event where investors have "prior access to information on the prices and quantities for which transactions may be undertaken." Construed in the context of the preceding rules on transparency, it appears that the scope of this provision apply to also the order-driven and

140 On the Annex see above in subsection 3.6. The instruments referred to in this Article are those mentioned in Section B of the Annex.

141 Cf. the wording "for *each of the regulated markets* it has entered on the list provided for in Art. 16." Emphasis added.

quote-driven markets. It is required in this case that the information shall be available "at all times during market trading hours" and that the terms announced for a given price and quantity "shall be terms on which it is possible for an investor to carry out" a transaction.

This rule seems to be for the benefit of the investor, considering that it secures a fixed price for potential transactions. However, it may also have the unfortunate effect to encourage the national legal systems to prevent the investors access to the relevant information bearing in mind the obligations arising from the provision. The question is therefore whether the investors' interests were better protected without particularly the last rule prescribing that the investor shall be entitled to carry on the transaction. It gives rise to the unanswered question what means of reaction the investor may invoke if he is not able to carry on the transaction in accordance with the conditions published. The ISD does not contain any indications which could lead to an answer. It is accordingly submitted that the rule, as it stands presently, shall be considered as a *lex imperfecta*, that is to say, that the investor is granted an unconditional right, but it is not enforceable. Due to the fact that the provision stipulates the minimum requirements the national legislation must meet when implementing the ISD[142] is it suggested that the Member States ought consider whether the national legislation should entail a sanction in case where the investor's rights are not complied with.

7 Conclusions

The internal market for investment services is aimed achieved by the Investment Services Directive. In some of the preceding subsections is it questioned whether the solutions adopted by the ISD constitute the appropriate answer to the problems connected with the liberalisation of investment services. This applies particularly with respect to access to the regulated markets in the host state, where the Investment Services Directive is apparently ambiguous.

However, it should be borne in mind that the character of the Community's legislation to a certain extent must entail legal uncertainty. This is a consequence of the fact that Directives prescribes the aims to be achieved rather than precise legal obligations. Secondly, certain legal expressions which are used throughout the Investment Services Directive are deliberately vague. This applies for example with respect to the concept of the general good which are one of the corner stones of the Directive. Thus, legal practitioners and the national bodies responsible for the implementation of the Investment Service Directive are left with very little guidance from the wording of the Directive.

The approach of mutual recognition and home country control reflects the (new) legal methodology in the Community's harmonisation process. It must be admitted that this approach in reality facilitates the possibility of border crossing activities at Community level. The underlying philosophy of mutual recognition is harmonisation of the particular national markets is unnecessary for the implementation of the internal market in investment services. What matters for the Community legislator is that genuine access to the national markets is secured. This

142 See above in subsection 6.1.

approach implies that there will not be one single legislation that covers the whole internal market. Instead, there will be twelve separate markets with individual characteristics. The example of the regulated markets is illustrative. The Investment Services Directive lays down rules governing such markets, but is silent as to *how* the regulation shall be carried on in practice, and the sorts of securities that are in circulation on such markets. The chosen approach in the context of the Investment Services Directive is therefore not related to a detailed harmonisation of the existing markets, but rather to secure that those markets are accessible for foreign undertakings on equal footing with the national operators on the market. It might therefore be argued that the legislation in the investment services field respect the Community principle of subsidiarity, as inserted in the EC Treaty by the Maastricht Treaty.

However, there is a disadvantage attached to the adopted methodology. In the absence of one common set of rules applicable to all investment services carried on throughout the Community, the market lacks transparency in the sense of predictability. In other words, it might be questioned whether the internal market the dilemma the Community legislator is faced with when adopting legislation for investment services exists, taking into account, that the market remains in twelve different fragments.

The Investment Services Directive constitutes an illustrative example on which is intended to implement the internal market. On the one hand, a genuine harmonization of each particular market within the Community, will involve a detailed and substantial legislation, and might take long time to agree upon in the competent bodies of the Community. On the other hand, legislation that possesses the characteristics like the Investment Services Directive, might be easy to implement albeit is more likely to result in legal uncertainty throughout the Community.

As a consequence of the aforementioned arguments, is it submitted that the Investment Services Directive should not bee seen as the ultimate goal for the internal market in investment services. It could be considered as one of the milestones which leads to a unified market. The question that remains to be answered is whether new Community legislation is necessary or whether the national legal systems gradually will converge.