1. The inadequacy of national regulation for today’s capital markets

Technical developments and legal freedom of markets permit to assert that the securities markets are not any longer attached to any particular city or country. Within the above statement, the introduction of the euro, the re-denomination of a huge amount of public and private securities, the conversion into euro of all organised markets in the euro-area, have created a new scenario for Europe.

This occurs in a situation where financial regulation is a matter that basically belongs to the national regulators. The Community has a series of directives that have left to Member States a wide room of manoeuvre and produced a situation where economic agents need to ascertain the national legislation before implementing their financial decisions. Europe is far from having a single set of rules in the capital markets.

It is submitted that national law is inadequate to address and encompass the regulation of today’s globalised securities markets. Some recent market developments show such inadequacy:

- The establishment in 1998 of Eurex (European Exchanges) following the functional merger of the Frankfurt’s Deutsche Terminbörse (DTB) and the Zurich’s Swiss Options and Futures Exchange (SOFFEX). Eurex is an organised market for derivative products on money, bond, equity and index markets. Eurex aims at achieving a fully global derivatives market, some evidence of which is the signing of contracts in 1999 with the Helsinki Exchange (HEX), and in July 2000 with the Chicago Board of Trade (CBOT), the first foreseeing reciprocal access of products and trades between Eurex and HEX, and the second allowing for reciprocal access and agreeing on a common technology. Eurex, moreover, admits remote participants and its members currently include traders in New York,

- The global consolidation of stock exchanges, where news appear every day on several cross-border mergers or association projects: the merger, due to be effective on January 2001, of the stock exchanges of Paris, Brussels and Amsterdam, under the name **Euronext**; the merger between the stock exchanges of London and Frankfurt, subject still to several regulatory and internal hurdles, under the name **iX**; the association of Nasdaq to **iX**; the talks between Euronext and **iX** for possible links; the talks between the NYSE and Euronext for a possible alliance; the launching of **Virt-x**, a joint anglo-swiss single trading platform with a single rulebook and a common clearing house and settlement system, created by London’s Tradepoint and Zurich’s Swiss Exchange (SWX).

- The consolidation between securities settlement systems (SSSs): functional merger of the central depositories of Germany (DBC) and Luxembourg (Cedel) under the name **Clearstream**; the absorption of the SSSs of France (Sicovam) by the Belgian **Euroclear**; the talks between the U.K.’s SSSs (CrestCo) and Clearstream; and the some 70 bilateral legal and technological links between the SSSs of Europe organised and co-ordinated by the industry association **ECSDA**.

The markets and organisations that result from the above examples are plurinational, and in the absence of international laws and regulations the consolidation has taken place keeping compliance with the existing national legal, regulatory and supervisory structures and admitting, thus, dual or triple legal structures in spite of functional singleness of the merged markets.

An good example in this respect is the case of Eurex, succesfully in operation since 1998. Although from a functional perspective it operates from Frankfurt with a single trading and clearing electronic platform, with one network, one clearing house and a single set of trading rules, from a legal, regulatory and supervision perspective the two original exchanges subsist (with the new names of Eurex Deutschland and Eurex Zurich) and are subject to both the German and Swiss laws and supervision; the German and Swiss supervisors have signed a Memorandum of Understanding
purported to achieve full co-ordination regarding Eurex. The complexity of the legal structure in place is evident from the charts annexed to this paper.

A similar case is Clearstream, the result of the merger between the SSSs of Germany and Luxembourg, where the two initial legal entities subsist (re-named Clearstream Banking Frankfurt AG and Clearstream Banking Luxembourg S.A., both being subsidiaries of a Luxembourg holding company), and the two legal, regulatory and supervisory structures also subsist in spite of the functioning of a single operational SSS under a common management and technology. The merged SSS has regional offices around the globe to allow for 24 hours permanent service.

It is still to be seen what will be the final legal, regulatory and supervisory structure of the two current consolidation processes of European stock exchanges, iX (+Nasdaq?) and Euronext (+NYSE?, or +iX?).

The question that arises is what would have to be the legal, regulatory and supervisory framework for organised markets, clearing houses or SSSs that are the result of more than two original entities, or which trade on a permanent basis in several jurisdictions. What might be admissible in mergers of two may not be admissible in mergers of more: dual-track structures are burdensome and inefficient, but three and more plurinational structures cannot be operational.

The existing situation and forthcoming developments is beyond the capacity of national legislators.

2.- The inadequacy of Community legislation to regulate today’s capital markets.

The first approach that comes to mind for European capital markets is that the Community may provide the common financial regulation needed to achieve the integration of the capital markets within Europe. The European Council at its meeting in Cardiff in 1998, a few months before the introduction of the euro, already recognized the existing inadequacies of diverse national regulation and instructed the Commission to table a ‘framework for action’ to improve the single market for financial services, and, in particular, to ‘identify the weaknesses which may require
amending legislation’. The Commission took this mandate on board, made a wide-ranging consultation of European-level representative bodies of financial services users, market practitioners, financial entities, and national administrations, and submitted to the Council later that same year a comprehensive plan called a ‘Financial Services Action Plan’\(^2\) which was endorsed by the European Council of Cologne in 1999. The more recent European summit in Lisbon set a deadline for its full implementation in 2005. This European Commission plan contains a legislative program targeted at removing the identified regulatory barriers, building basically on the existing Community framework.

Community legislation is hampered by some difficulties that may be systematised in three big blocks:

(a) **Territorial limitation.** - Capital markets are today global, and the Community is a geographical area limited by its constituent membership. Community legislation would not be able to provide a single set of rules for the merger between a Community exchange like the Deutsche Terminbörse, and a non-Community exchange like the Swiss Options and Futures Exchange –SOFFEX- which lead eventually in 1998 to the Frankfurt’s Eurex exchange. It cannot provide itself alone for cross-Atlantic arrangements (Nasdaq, NYSE, CBOT). Even if the Community would deliver a comprehensive and detail securities market regulation, its territorial application could not encompass the global markets of today.

(b) **Constitutional limitations.** - After 40 years of European Community, the European legislative framework for capital markets, although extremely valuable, is neither comprehensive nor systematic, and integration of capital markets would warrant an important and renewed legislative effort, part of which already contemplated in the Commission’s Action Plan. Such legislative effort is however hampered by some basic Treaty principles of ‘constitutional nature’. These are the following:

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(i) **Subsidiarity** and proportionality. These principles are established in Article 5 of the Treaty and developed by a Protocol approved at the Treaty revision in Amsterdam. Such Protocol is a part of the Treaty and has the status of ‘primary law’. In a nutshell, it contains the following rules:

- Community legislation should be “as simple as possible” and “only to the extent necessary”; in today’s complex financial world, capital market regulation cannot be simple and requires both comprehensiveness and detail;

- “Directives should be preferred to regulations”, “shall leave to the national authorities the choice of form and methods”, “should leave as much scope for national decision as possible”, and “should provide Member States with alternative ways to achieve the objectives of the measures”.

(ii) Principle of attributed competence or sufficient **legal basis** to legislate. This principle is enshrined in Article 5 of the Treaty. Which would be the legal basis for enacting common financial market regulations? Possibilities are the following: **Articles 43 to 55** regarding right of establishment and free provision of services, which require for harmonisation to be seen as necessary in order to establish the internal market. This legal basis has been used for harmonisation of Company Law, for the Banking Directives⁵, for the ISD, for the Listing and Prospectus directives, etc. **Article 65** is a suitable legal base to adopt legislation regarding civil and commercial proceedings and on conflicts of law and of jurisdiction. It has served as legal basis for the recently adopted EU Regulation on Insolvency Proceedings⁶. It cannot serve as a basis for substantive financial regulation. **Articles 94 to 97** on “Approximation of laws” provide a legal basis for directives (the only instrument permitted here is the directive) if and when the objective is to achieve or maintain the internal market (Article 14 sets the Community aim of establishing an internal market), and it has been used, for instance, to adopt the

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Settlement Finality Directive\(^5\). **Article 123(4)** may be quoted as a valid legal basis to adopt “the other measures necessary for the rapid introduction of the [euro] as the single currency of those [participating] Member States”; it would be questionable whether establishing a common regulation for the euro capital markets may be done under that base. Finally, **Article 308** is a subsidiary legal base not linked to the internal market, but merely requiring that a Community action be necessary in order to attain a Community objective. The ECJ’s Opinion 2/94 [1996]\(^6\) has established the ‘constitutional limitations’ to the use of Article 308 as legal basis for legislation: it cannot serve for widening the scope of Community powers, nor to implicitly amend the Treaty. The main problem to face in all these legal basis is that ‘establishing and internal market’ has been conceived as (i) the dismantling of barriers to free movements of goods, services, capital and persons, (ii) the harmonisation of access rules and (iii) the attribution of competences (i.e. host state versus home state jurisdictional issues). It consisted of elimination of market compartmentalisation. The surge of a unified body of rules for the already existing internal market may be seen as one step beyond the powers currently attributed to the Community. Lack of uniform rules, and differences between national legal systems, may entail more costs in cross-border transactions, but costs are not an obstacle to the internal market and thus reduction of legal costs in cross-border activities is not a Community objective. A better functioning of the euro capital markets may not be seen as justification for Community legislation, which aims only to the creation of an internal market.

(c) **Legislative limitations**.- Community legislative techniques have two kinds of limitations that make them inadequate to address the moving scenario of capital markets:

(i) Directives do not achieve **uniformity** of rules. The use of directives entails granting Member States leeway to implement them. After the Protocol on subsidiarity and proportionality attached to the Amsterdam

Treaty, detailed directives - peacefully admitted in the past - seem to be now a foregone possibility. An example of the above is the Settlement Finality Directive, whose Article 9(2) aims at harmonising the conflict-of-laws rules applying to rights on securities placed and traded in a multi-jurisdictional market, whereby national law implementation has left a situation of non-harmonization. Current directives on capital markets are directives purporting a *de minimis* harmonization, whereby Member States may add to the content of the directives. In addition, it is very common to see in all these directives a provision enabling the Member State “to take any appropriate measure in the interest of the general good”, which permits departure from common rules. This kind of open provision has triggered ECJ case law specifying what ‘general good’ means in concrete cases, and a Commission ‘Interpretative communication’ setting the basic parameters of what such an open window means. An example of the problems faced by *de minimis* directives is the Prospectus directive, which gives leeway to Member States to add items for the prospectuses of new securities, imposing on issuers the need to ascertain national prospectus requirements before placing securities on a multi-jurisdictional basis. Community directives are the result of compromise and political negotiation, and are dependent on political events and priorities, finally ending up being the lowest common denominator between Member States’ positions, and rarely being a perfect, comprehensive, and consistent piece of legislative art.

(ii) Directives do not keep the pace of market changes.- The legislative process to adopt Community directives takes an awful amount of time, especially if the ‘implementation time’ at Member State level is added to the usually long periods that the Community legislative process entails. The accelerated final deadline for the Commission’s Financial Services Action Plan has been set at the year 2005. Even if that deadline were to be achieved, the additional implementation time would mean 2007, i.e. eight years since the introduction of the euro. The speed of changes in the financial markets and in the economy in general would require a

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6 ECR I-1763
legislative system “plus agile”, namely to adopt subsequent amendments if changing circumstances so recommend.

However, the Community may find ways and means to accommodate market need for speed and flexibility. For instance, by way of approving ‘fast-track’ legislative procedures, such as the so-called ‘comitology’ procedure used in the common agricultural policy, in statistics or in the customs union. Although seen with circumspection by the Member States, this procedure may be well suited for detailed and complex securities markets regulation. This ‘comitology’ procedure is, for instance, admitted to introduce technical amendments in the banking directives, by using the Banking Advisory Committee as the relevant committee. The avenue of using ‘soft law’ measures, such as communications or recommendations, may be of interest, but here again Member States have been concerned in the past that the Commission does not use these quasi-legislative means to overstep on subsidiarity and on national competences.

It does not need to be mentioned here that the ECB is not a regulator of the capital markets. The ECB is or may be a regulator for activities close to central bank tasks: financial statistics, monetary policy, payment and clearing systems. The ECB may set standards or criteria against which to measure the suitability of entities, securities, techniques, or other, to operate with the Eurosystem. Article 105(6) enables the Community to entrust specific supervisory functions to the ECB; so far, use of this possibility is not foreseen. The ECB cannot thus be a regulator for the euro capital markets.

The ECOFIN meeting that took place in Brussels last 17th July 2000 acknowledged some of the above-described difficulties and decided to set up a committee of seven wise men with the mandate:

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7 SEC(97)1193 final, 20.06.1997
- “to assess the current conditions for implementation of the regulation of the securities markets in the European Union;
- to assess how the mechanism for regulating the securities markets in the European Union can best respond to developments under way on the securities markets, including the creation of markets resulting from either the alliance of European and non-European stock exchanges or from technical innovation (ATS\(^{10}\)), while still guaranteeing the effective and dynamic operation of markets throughout the European Union to achieve a level playing field;
- in order to eliminate barriers and obstacles, propose as a result scenarios for adapting current practices in order to ensure greater convergence and co-operation in day-to-day implementation and take into account new developments on the markets.”

The ‘wise men’ are to report in November 2000 and finally in the first half of 2001 to the ECOFIN Council.


Given the inadequacy of national and of Community regulation to satisfy the regulatory needs of today’s capital markets, and in the obvious absence of any ‘global regulator’, the avenue which is here submitted is the technique of self-regulation.

The term ‘self-regulation’ is used here in a wide manner to include both the adoption and use of contractually-agreed standard trading terms, as well as the exercise of regulatory function by market bodies entitled, by either its own by-laws or by a recognition to do so in a public legal act, to bind their members, irrespective of whether there are public authorities monitoring, supervising or intervening in their affairs. Self-regulation is not ‘soft law’. It is legally binding, because contract is law for those privy to it, within the boundaries of the organisation that has adopted the rules and standards, which often may police and ensure due compliance with such regulations and, in the extreme case, expel the non-compliant.

\(^{10}\) Alternative Trading Systems.
Self-regulation is fundamentally grounded on freedom of contract, which ranks high and wide in both European and American legal systems, and on freedom of association. Its rationale relies on the idea that those in the market are best positioned to agree on the rules that have to govern their activities. Market participants are able to establish an institutional mechanism of rule-elaboration to which members of the associative body oblige themselves to adhere. Such contractual and associative origin may be at the base of market organisations establishing standards and rules governing the activity of its members. Limits to freedom of contract in this domain may be established by mandatory laws, which in this area tend to relate to investor/consumer protection and to prudential supervision. Self-regulation is compatible with public regulation; where public regulation exist, self-regulation takes a subordinate role. To the extent that self-regulation is not incompatible with, or even contributes to, the aims of both areas of mandatory law, one cannot but enhance the merits of self-regulation.

Self-regulation (i) provides a useful tool to achieve cross-border uniformity of capital markets rules, (ii) gives an indication of market preferences for the national and the Community legislators, (iii) when satisfactory, avoids the need for legislation, (iv) does not have per se geographical boundaries, and (v) does not present the constitutional and legislative problems above-mentioned. Self-regulation should be, of course, fully compatible with, and subordinated to, available Community legislation.

There are some examples of financial markets self-regulation already on hand.

(a) **Euro markets.** The financial market has not remained inactive in harmonising some of the contractual framework for the euro-era. Euro-denominated payments have flowed since January 1999 throughout the banking system of the whole Community. Interbank payments are the subject of either explicit contractual agreements or established practices; the new multi-jurisdictional dimension of such flows has encouraged a group of banks spontaneously to harmonize some of the rules. This initiative emerged from a forum of some 30 leading banks from Europe and New York known as the ‘Heathrow Group’ (so named in consideration of the normal place of the group’s gatherings). A series of conventions and guidelines were agreed in this informal forum, which subsists as
Meeting place for issues related to interbank euro payments. National conventions, criteria and practices were replaced by single rules. In addition to this, the European Banking Federation adopted and published in December 1998 a set of ‘Guidelines on liquidity management within the framework of TARGET’, to be complied with by the participants of the euro inter-bank money market. In the course of 1998, fostered by several market organizations, there was agreement regarding some of the techniques and concepts used by credit institutions: the so-called ‘market conventions’ referring to, for instance, the manner of computing interest rates, the periodicity of paying interest coupons, treatment of bank holidays, time differences, the method of making and describing rates between currencies, and the settlement periods (i.e. same day, 2 days, etc.). In addition to this, market organisations were behind the establishment in 1998 of the Euribor and EONIA as the euro-area money market reference rate, setting the path for the termination of national reference rates. In the course of 1999, sponsored by the European Banking Federation and other credit market organizations, a standard agreement for repo and other transactions involving netting clauses was approved (‘European Master Agreement’ or ‘EMA’), to replace the several models used in the domestic markets of continental Member States. In spite of having been seen as an alternative to the PSA/ISMA global master repurchase agreement (‘GMRA’), the EMA serves the purpose of unification, since domestic markets did not normally utilized the Anglo-American-styled GMRA, used mainly in New York, London and in the international market. In the domestic markets of the eurozone, the use of such standard documentation, prepared under either a New York or English legal perspective, is limited, and even inadequate. During 1999 and 2000, the European Central Securities Depositories Association (ECSDA), have agreed on the standards to be implemented by its member SSSs to link among themselves; such standards cover the legal arrangements and the operational, communications and technical requirements. The ECB first set out its own standards for the links of the SSSs, then assessed 64 of those linkages against its own set of ECB standards, and following that assessment admitted so far 62 of them for the cross-border use of collateral by the Eurosystem.

(b) **The US securities markets.** The Securities Exchanges Act of 1934 (‘US 1934 Act’) contained several provisions (namely, Sections 11A, 15 and 19) foreseeing what was termed as “self-regulatory organizations” (‘SRO’). Section 19 of the US 1934 Act contained the regime of the SROs. Today there are fifteen SROs recognised by the Securities and Exchange Commission (‘SEC’), 8 of which are stock exchanges, 4 are clearing organisations, and 3 are rule-making professional organisations. These SROs have their own ‘Rulebooks’ establishing the regulation for their affiliates and respective markets. In some cases, provisions about rule-making and compliance are quite detailed. The SEC monitors their activity and has an upper hand in ensuring compatibility of their Rulebooks with the public interest. In addition, the US Commodities Futures Trading Commission (‘CFTC’) has vested most of its regulatory responsibilities over commodities and futures exchanges to SROs subject to CFTC oversight, including all the US commodities exchanges and the National Futures Association. The self-regulatory system of the USA has worked remarkably well. This is all the more valuable for Europe because of the mix, in the domain of the capital markets, of federal and state competences. In fact, the approach towards self-regulation embedded in the US 1934 Act came precisely with the purpose of avoiding the risk that the Supreme Court would declare unconstitutional such federal legislation, as it did for several laws adopted by the New Deal Administration introduced by President Roosevelt in the 30s that overstepped into the states’ competences.

(c) **The City of London.** The Financial Services Act 1986 (UK 1986 Act) imposed statutory regulation for the first time. In doing so it recognised the appropriateness of the traditional system of self-regulation whereby the regulators were appointed by the industry itself, but submitted these SROs to the overarching control of a

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12 Such a vigilant attitude of the Supreme Court about the boundaries between the federation and the states triggered an intent by President Roosevelt to raise the number of Supreme Court judges from nine to fifteen, and appoint sympathetic judges; such intent did not succeed due to fierce opposition by public opinion and by Congress.

13 Except for the banking sector, for insurance and for specific kinds of financial players. Until the First Banking Co-ordination Directive of 1977 (‘FBCD’), the banks in the UK were subject to a loose regulation from the Bank of England, who never exercised its statutory power to issue ‘recommendations’ to banks, and to consumer protection rules enacted by the DTI in 1974. The FBCD was implemented in the UK in the Banking Act 1979, and since then the Bank of England is the statutory regulator of the banking sector in the UK. Insurance companies were subject to regulation and supervision since insurance legislation enacted in 1870. Friendly Societies, co-operatives and mutuals had had public regulation since the XIXth century.
semi-self-regulatory body, the Securities and Investments Board (‘SIB’), itself subject to the control of HM Treasury. Any person active in the financial markets had to belong to a SRO approved by the SIB, and such SRO had to ensure compliance by its members to the rules of the SRO. Within that system, half a dozen SROs\textsuperscript{14} were recognised by the SIB, whilst commercial banks kept being subject to the jurisdiction of the Bank of England\textsuperscript{15}, the London Stock Exchange kept its traditional self-regulatory powers, and the insurance sector kept being subject to the Department of Trade and Industry’s (‘DTI’) rulemaking and supervision. The SIB was entitled to issue “core rules” of direct compulsory application to all SROs. Thus, the financial activity of the City was governed by a self-regulatory system which functioned satisfactorily except for the fact that the demarcation lines between financial activities started to blur, and a single entity entering several markets had to be subject to more than one SRO and to more than one set of rules. This inconvenience triggered the establishment of the Financial Services Authority (‘FSA’) in 1997, which did not have regulatory power of its own until the recent enactment of the Financial Services and Markets legislation. From 1997 until 2000 the FSA embodied only \textit{de facto} the six existing SROs, plus the SIB, the supervisory arm of the Bank of England, and the Insurance Department of the DTI. Thus, in a nutshell, the City of London has been an international financial centre based on self-regulation since its origin and until this year 2000 where the FSA has been granted regulatory power of its own. The London Panel for Takeovers and Mergers may also be mentioned as a paradigm of self-regulation, whereby industry representatives were entitled to promote conventions of behaviour for take-overs. By the 1980’s its role had assumed such importance that it was ruled by the courts to be susceptible to judicial review, on the ground that it \textit{de facto} fulfilled a public function. The Takeover Directive will require all such bodies to be based in statute.

\textbf{(d) The Eurobond market.} - One of the most successful markets, the Eurobond market, blossomed without being subject to any regulatory authority, free of controls be either individual governments, the Community or other international

\textsuperscript{14} A process of consolidation developed whereby market organisations merged to form the SROs governing each area of the financial market.

\textsuperscript{15} See footnote 8.
organizations. It has its own SROs: the International Securities Markets Association (‘ISMA’) (formerly the Association of International Bond Dealers or ‘AIBD’), the International Primary Dealers Association (‘IPMA’), and the Euro Commercial Paper Association (‘ECPA’). To these, it should be added the International Swap and Derivatives Association (‘ISDA’), although that market organisation covers more than the Eurobond market. The clearing operations in this market was entrusted to the so-called ‘international central securities depositories ‘ICSDs’ (Cedel and Euroclear). All these SROs have been extremely active in the shaping of that Eurobond market, by setting all kind of rules and contract standards. In particular, ISDA’s master agreements have gone beyond bilateral relations to create a universal underlying legal structure for wholesale markets, influencing the application of the law (i.e. on capital consumption) and the elaboration of laws (i.e. validity of netting). And ISMA has performed the nearest thing to a market regulator: adoption of trading standards and recommendations in respect to the secondary market of eurobonds, thus regulating market conduct. Being a non-statutory body created (in 1969) by private contract between its own members, ISMA has no sanctioning power other than expulsion; nowadays ISMA’s membership comprises virtually all secondary traders of eurobonds, and thus expulsion would mean termination of access to the market. ISMA is based in Zurich, and it is not subject to any supervision by Swiss (or any other) supervisors.

What is the avenue for the capital markets of Europe?

One possible and relatively easy path for Europe would be to build on FESCO. In December 1997 the Forum of European Securities Commissions (‘FESCO’) was established under private law parameters, composed by the securities regulators and supervisors of 17 countries of the EEA area, plus representatives of the European Commission. A look into the website of FESCO\(^{16}\) will show that the motto on its home page is “Working together towards common European Securities Regulation”. Its activities are twofold: enhancing co-operation between the securities commissions in their role as supervisors, and elaborating common standards for regulation to be

\(^{16}\) www.europefesco.org
recommended to the European Commission for legislation, or to its members for adoption and implementation. So far, its activity is rather of a co-ordination and an advisory role, namely vis-à-vis the Commission and its legislative work; perhaps, it may be said that it begins to create ‘soft law’.

FESCO has the potential to become the centrepiece of European regulation for the capital markets. One easy possibility might be that these national regulators meeting in the context of FESCO, instead of using their regulatory power in an isolated manner for their domestic market, would ‘pool’ this power and endeavour to enact identical rules for each of the national markets, thus achieving the necessary uniformity in the substance. The Community would not need to legislate further there where the members of FESCO would produce uniform rules for the capital markets.

The FESCO approach would have the advantage of using the regulatory structures existing already in the Member States (and EEA), in the understanding that FESCO members by way of secondary regulation in their domestic markets may indeed contribute to harmonise if not to unify capital market rules. Not only future rules might be fully harmonised in that forum, but also a retrospective analysis may be done on existing rules, so as to foster amendments aimed at unifying national rulebooks.

A prerequisite for an enhanced role of FESCO would be clear and transparent rules on decision-making, perhaps adopting a general criteria of qualified majority but avoiding the unanimity rule which would allow for vetoes motivated by protectionist attitudes.

However, FESCO members operate within the context of national law, and there is where diversity still lies. The Community could entrust FESCO with the task of analysing the existing legal differences between EU Member States in the implementation of capital markets directives, and report to the Council. The Council may see the ways to eliminate distorting legal differences. For instance, current Codes of Business Conduct in the several Member States differ: FESCO may recommend a uniform code to the Council. The same might be said for Good Governance Codes,
where in spite of the similarity between the existing national ones, complete uniformity might be sought for today’s international equity markets.

Another possibility of deeper calibre would be to decide, at the highest political level, to go the way of wide, but controlled, self-regulation, meaning that the rule makers would not be public authorities like the members of FESCO, but representative market organizations.

European legislation should limit itself to organise a system of self-regulation, instead of aiming at achieving a comprehensive and state-of-the-art common rule book for the capital markets. In self-regulation systems there is always a tension between the independence of the self-regulatory organisations (SROs) and the public character and general interests concerns that rule-making entails. A balance needs to be drawn between these conflicting perspectives, and there is a wide body of doctrine and precedent on which to build\textsuperscript{17}.

In any event, a system of controlled self-regulation requires a framework established by law that provides for the adequate balance between the public interest and the interest of the market concerned. A Directive could organise European self-regulation in the securities markets, building on what the US 1934 Act or the UK 1986 Act did, by setting the criteria and procedures to recognise self-regulatory organisations (SROs), the parameters of public interest where mandatory public provisions would apply, and the Community’s means of control and overall direction over the SROs. Since now all EU Member States have a system of top-down public regulation of financial markets, such \textbf{Self-regulation Directive} (SRD) should also specify the areas where self-regulation is permitted, and impose on Member States the obligation to abrogate from their laws those mandatory provisions that may obstruct the uniform application of SRO rulebooks; this might be done by selecting in the existing capital markets Community \textit{acquis} those sections where self-regulation is permitted.

\textsuperscript{17} Self-regulation in financial markets has been very much an on-going topic in the U.K. as well as in the US; doctrine and case law abound on the issue of borderline between the public and the corporative interests of rule-making by SROs. In the UK, in particular, around the time where the Financial Services Act 1986 was passed, which gave a statutory basis to self-regulation, hitherto non-controlled,
SROs would need to be recognised by a Community authority, possibly the Commission. Community recognition would be dependent on SRO’s by-laws complying with the Treaty and with all parameters listed in the proposed SRD allowing for self-regulation. Power to recognise would entail the power to cancel the recognition in cases of damage to the public interest.

A first list of items where there is a public interest concern that the Commission should protect in a controlled self-regulatory scheme may be as follows:

(a) Composition of governing bodies of SROs: there is a public interest in such composition so that:

- All members may be subject to fit-and-proper standards in view of the semi-public function that rule-making entails, and include obligations of high standards of integrity.

- Undue conflicts of interests should be avoided, by establishing some standards for diversity of ownership or membership of SROs, ensuring that competitors within the same market have access to such organization and governing bodies.

- National protectionism should be impeded, by requiring international representativeness of the membership of SRO and of its governing bodies (i.e. European SRO recognition should only be given to those market or professional organizations that have a European or international constituency, rather than national or regional).

- By-laws should permit access of investors, consumers or participants in the market to the governing bodies of the SROs.

(b) Free competition. The main aim in the UK 1986 Act was to break the corporatism that had penetrated the existing self-regulatory bodies. Competition between SRO members has to be ensured. This needs to be pursued. Access rules should provide for an open market and not for a close-shop.

(c) Compliance with Community law. The rulebooks of SROs should be fully compliant with the Treaty principles and provisions, with Community Directives, and more recently on the occasion of the establishment of the Financial Services Authority with top-down regulatory powers.
and with general principles of Law (i.e. legitimate expectations and droits acquis, proportionality, etc.). A mechanism of ex ante control by the Commission or a public authority might be foreseen (i.e. so-called “sanctioned self-regulation system” or traditional Imprimatur system), both for initial approval and for subsequent amendments to by-laws. Due compliance with Treaty and Community secondary legislation of rulebooks (i.e. non-discrimination, free competition, clear and open access rules, consumer protection, etc.) should be ensured by administrative or judicial means.

(d) Elements of public law applying to a rule-making agency. Rule making should be subject to some basic procedural principles common in Europe: due motivation, transparency and publication, due consultation to both members and consumer organizations, clear procedural and decision-making rules, publicity (i.e. through Internet) and final control by a public authority.

(e) Enforceability. SROs should provide for an internal mechanism to ensure compliance by its members to the SRO rulebooks, with adequate and meaningful sanctions for infringements, a clear, accessible and well-publicised complaints procedure, and submission to an ombudsman scheme, to public administration monitoring and to judicial control.

(f) Public accountability. SROs should be subject to mechanisms of public accountability, such as periodical reporting and other publicity and information rules, adequate governance principles, establishment of an own ombudsman, transparency in its accounting and financial accountability, record-keeping rules, voluntary submission to the monitoring of the Community and of other public authorities, methods for management performance review by members, duty of appearance before parliamentary bodies, rules about civil liability of the SRO and its solvency, and other.

The above does not intend to be exhaustive, but rather a preliminary approach.

A system of ‘controlled self-regulation’ for the securities markets is the solution for a situation, described above, that may be qualified as the beyond the ‘limit of national and of Community legislation’. It has the following advantages:
- Technical expertise: rulebooks are done by the market and for the market, where the expertise lies;
- Flexibility to adapt to changing conditions: speed of developments in the securities markets requires a flexible and liberal approach, trusting that the market participants are the first interested in achieving a publicly reliable and efficient regulatory framework; top-down legislative schemes are rather rigid and difficult to alter, whilst the market may better adapt its rulebooks to market changes, subject to control by public authorities.
- Non limitation by territorial boundaries: SROs are to be considered as an intermediate body between public authorities concerned by the interests of the consumers, investors and of the public at large, and those of the financial intermediaries in a certain market; national or European boundaries would not be relevant and SRO rulebooks may have universal application. SRO may have non-Community components and application. SROs might be recognised by the SEC under the US 1934 Act. Other third country jurisdictions may be amenable to follow the self-regulatory pattern and accept the same SROs recognised in Europe.
- Respect for the public interest: SRO would be bound to Community law, subject to recognition, monitoring, and control by public authorities, to the set of criteria listed above (and perhaps other) envisaged to protect the public interest that the SRD should in any case require for all SROs.
- Avoidance of the difficult ‘constitutional’ and political problems of building a uniform framework at the European level, perhaps with the establishment of a new pan-European securities regulator; self-regulation seems to be also more in line with the market-friendly and liberal principles of the European Community, which is also the ‘spirit of the time’ in the domain of securities.
- Self-regulation permits keeping the role of supervision were it is: single rulebooks are compatible with plurality of supervisory bodies, although ideally the supervisory schemes should end by adapting themselves to the new scenario, first, perhaps, by strengthening co-operation, as done within FESCO, when supervising market participants. But no need, *ab initio*, to start by creating a European supervisor.
By building on the experience of the US and the UK, the framework on which a controlled self-regulatory system might be established would be able to satisfy the concerns of political representatives, of course inclined to preserve for public administrations the task of rule-making.

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