

2. EUROPE 1992: SECTOR-RELATED CHANGES

Significant progress has already been achieved in unifying the financial sector. The Directive on Liberalization of Capital Movements, adopted in 1988, set a June 30, 1990, deadline for the removal of restrictions on capital movements for most Member States. The Directive embodies the principle of liberalizing flows of capital to and from third countries as well as within the Community. This is a commitment to an *open* European market.

The EC is now setting up a package of regulations to implement home country control and mutual recognition.

2.1 Principles of the Single European Act

The concept of *home country control* is well adapted to banking, for which regulations tend to concentrate on financial soundness, particularly the adequacy of banks' capital resources, since these guarantee the safety of depositors' money. Under home country control, judgement on the soundness of a bank can only be made by home country authorities who are in a position to assess interrelated factors such as management quality, risk appreciation and control systems. Currently, most EC countries prohibit banks and other financial institutions from offering services unless they are established locally and conform with local regulations.

The second fundamental principle of the Single European Act is *mutual recognition* by EC Member States of each other's systems. The regulations of each country apply to its citizens throughout the EC. This is a totally different approach to decision-making, which previously required all Member States to agree in every detail.

2.2 The Second Banking Directive

The new principles are also the basis of the Second Banking Directive, issued by the European Commission in January 1988. This Directive is the cornerstone of banking regulations; it was approved in December 1989 by the European Parliament, and approval is also expected from the Council of Ministers in the near future. The Directive will take effect on January 1, 1993.

The Second Banking Directive does not differentiate between commercial or investment banks or financial institutions, but rather lists a wide range of financial services delivered by "Credit Institutions": these include lending, leasing, foreign exchange services, financial futures, credit cards, fund management and securities trading.

The main concerns of the Second Banking Directives are outlined below.

a) A Single Banking Licence

The desire for a single banking licence is a consequence of mutual recognition. Once a bank has been authorized in one EC Member State, it will be free to open branches in any other EC country without first obtaining authorization there. Opening branches is now possible in most of the EC countries, but the new system will reduce costs and bureaucracy.

Countries with tough regulations will be pressured to liberalize; competitors from countries governed by less restrictive rules would have an advantage over domestic banks.

A single banking licence could also create anomalies because banks from non-EC countries would be allowed to perform services in the EC not permitted in their home country. For instance, Japanese commercial banks are underwriting corporate bonds in Europe, an activity that Article 65, Japan's equivalent of America's