German Banking Law and Practice in International Perspective

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Preface

In a time of global banking and financial services, globalized money and capital markets, a look on German banking law and practice might be attractive also for lawyers, bankers and businessmen outside Germany. The articles in this book are designed to cover the subject in a systematic approach. They are written by experts from authorities, banks and universities. The idea to this book was born in a conference on „German and Chinese Banking Law" held in Beijing/China October 6-8, 1997, and co-sponsored by the Law Centre for European and International Cooperation, Cologne (R.I.Z.), and the China University of Political Science and Law, Beijing. Inspired by this conference, the authors wrote their contributions in 1998 with due regard to the comparative and international legal perspective of the subject.

A picture of German banking law and practice would be incomplete if it did not introduce to the fact that German banking practice and capital market operations form part of the Euro area and the Common Market. Accordingly, the book contains an article on „The Institutional and Legal Framework for the European Monetary Union" from a German perspective and another one on „The Internal Market for Banking and Investment Services", both written by the editor. Both articles are revised versions of speeches, the first one held at the University of California, Law School, Berkeley and Davis, on October 8-9, 1998; the second article was a contribution to the German Norwegian Lawyers Conference in Munich on October 25, 1998.

All contributions were carefully edited by Professor Luke Nottage, Kyushu University, Japan, and Paul Salazar (R.I.Z.), whose endeavours are gratefully recognized. I should like to thank also Dr. Ulrich Wackerbarth (R.I.Z.) for his support in the editorial work.

All authors and the editor hope that the book will make a useful contribution to the ongoing global discussion on a harmonized banking and financial law as an important tool for an enhanced international economic and financial cooperation.

Cologne, April 1999 Norbert Horn

Survey

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Abbreviations

AG	Aktiengesellschaft (stock corporation)
AGB	Allgemeine Geschäftsbedingungen (standard terms, general business conditions)
AGBG	Gesetz über die Allgemeinen Geschäftsbedingungen (standard terms act, standard form contracts act)
AktG	Aktiengesetz (stock corporation act)
AO	Abgabenordnung (tax code)
Art.	Article
BAKred	Bundesaufsichtsamt für das Kreditwesen (see FSBO)
BAWe	Bundesaufsichtsamt für den Wertpapierhandel (see FASTO)
BB	Betriebsberater
BGB	Bürgerliches Gesetzbuch (civil code)
BGBl	Bundesgesetzblatt (Federal Gazette)
BGH	Bundesgerichtshof (Federal Supreme Court, Federal Court of Justice)
BNotO	Bundesnotarordnung (federal act on notaries)
BörsG	Börsengesetz (exchange act)
BVerfG	Bundesverfassungsgericht (Federal Constitutional Court)
CAD	EC Capital Adequacy Directive
Div.	Division, Department
EBRD	European Bank for Reconstruction and Development
EC	European Community (see also EEC)
ECB	European Central Bank
ECT	Treaty Establishing the European Community
EEA	European Economic Area
EEC	European Economic Community (see EC)
EFTA	European Free Trade Association
EGBGB	Einführungsgesetz zum Bürgerlichen Gesetzbuch (introductory law of the civil code, contains intertemporal and international choice of law rules)
EIB	European Investment Bank
EMI	European Monetary Institute
EMU	European Monetary Union (Europäische Währungsunion)
ESCB	European System of Central Banks
EStG	Einkommensteuergesetz (income tax act)
EU	European Union

FASTO	Federal Securities Trading Supervisory Office (Bundesaufsichtsamt für den Wertpapierhandel)
FBSO	Federal Banking Supervisory Office (Bundesaufsichtsamt für das Kreditwesen)
FIBOR	Frankfurt Interbank Offered Rate
GG	Grundgesetz (basic law, constitution)
GmbH	Gesellschaft mit beschränkter Haftung (close corporation)
GWB	Gesetz gegen Wettbewerbsbeschränkungen (act against restraints of competition (german antitrust law))
HaustürWG	Gesetz über den Widerruf von Haustürgeschäften und ähnlichen Geschäften (law regarding revocatin of door-to-door and similar dealings)
HGB	Handelsgesetzbuch (commercial code)
InsO	Insolvenzordnung (bankruptcy code (since 1999), see also KO)
ISD	EC Investments Services Directive
KfW	Kreditanstalt für Wiederaufbau (Reconstruction Loan Corporation)
KO	Konkursordnung (bankruptcy code (until 1998), see also InsO)
KWG	Kreditwesengesetz (banking act)
LIBOR	London Interbank Offered Rate
NJW	Neue Juristische Wochenschrift
RG	Reichsgericht (Supreme Court of the Reich)
StPO	Strafprozeßordnung (code of criminal procedure)
TA	Treaty of Amsterdam
UWG	Gesetz gegen den unlauteren Wettbewerb (unfair competition act)
VAG	Versicherungsaufsichtsgesetz (insurance supervisory law)
VerbrKrG	Verbraucherkreditgesetz (consumer credit act)
VVG	Versicherungsvertragsgesetz (insurance contract act)
WM	Wertpapiermitteilungen
WpDRiL	Wertpapierdienstleistungsrichtlinie (see ISD and WpHG)
WpHG	Wertpapierhandelsgesetz (securities trading act)
ZIP	Zeitschrift für Wirtschaftsrecht
ZPO	Zivilprozeßordnung (code of civil procedure)
ZVG	Zwangsvollstreckungsgesetz (compulsory enforcement act)

Introduction

Norbert Horn

I. Market Economy, Banking, and the Law

Germany can play its role in world economy as one of the leading industrial States with a strong export position only on the basis of a highly developed and well functioning banking system. Such a banking system is the basis of every market economy. A market economy disposes of an effective capital allocation through the invisible hand of offer and demand, and this mechanism is based on the freedom of the great number of market participants to pursue their business activities exercising personal responsibility, and to make their own decisions on how to borrow money, how to lend money, and how to invest it. In Germany, the freedom of economic activities and private property is protected by the constitution (Art. 2 and 14 Basic Law (Grundgesetz, GG)) and it is also guaranteed by the Treaty on the European Union.

Banking law can be defined as all laws regulating the activities of banks. Such laws can either be specifically made for banks alone, or they may regulate all kinds of business activities. The banking laws may be part of public law, or of private law. Public law is (at least in Continental European thinking) the law regulating the activities of the State and of governmental authorities (*infra* II). Private law is the law that regulates the activities of all citizens such as the law of contracts or company law (*infra* III). German banking law does not depend on the decisions of the German legislator alone. Germany is a Member of the European Community (and European Union) and banking law has been harmonised to a large extent within the Community.

II. The Public Law of Banking

Within the area of German public law, the most important laws specifically made for banking activities are (i) the German Federal Bank Law (Bundesbankgesetz), (ii) the Credit Institutions Law (Kreditwesengesetz), and (iii) the Treaty of Maastricht on European Monetary Union.

The German Federal Bank Law regulates the activities of the Deutsche Bundesbank, the German Federal Bank. This bank provides liquidity for the banking system and is now integrated into the European System of Central Banks. Fur-

thermore, the Central Bank has to provide a payment system within Germany and with foreign countries. In its monetary policy, the Central Bank is obliged to support economic growth, to avoid inflation and to cooperate with the Federal Government. In its decisions as to monetary policy, however, the Central Bank is strictly independent. In German legal tradition, this independence of the Central Bank is a corner stone of the Central Bank System, and this principle has been used for building up the European System of Central Banks (*infra* chapter 1 and chapter 2).

The German Law on Credit Institutions (Kreditwesengesetz) establishes a Federal Authority for the prudential supervision of the banks. An enterprise that wishes to start banking business needs a license from this federal authority (*infra* chapter 3). German financial market and stock exchanges play an important role in the context of globalized financial markets (*infra* chapter 4). The laws on prudential supervision of banking and investment services have been simplified and harmonised within the European Community, and this will, together with the introduction of the single currency euro, contribute to the establishment of an integrated internal financial market within the Community (chapter 5).

III. The Private Law of Banking

The business transactions of banks with their private or commercial customers or with other banks are subject to private law. We do not find much specific legislation as to banking activities in this field. The banks simply participate in business life as other merchants and enterprises, and they are subject to the general rules of contract law and tort liability as spelled out in the German Civil Code (Bürgerliches Gesetzbuch; BGB) and Commercial Code (Handelsgesetzbuch; HGB). The majority of banks is organised as companies under the German Company Law. The ownership of those banks is spread among many shareholders. Other bank are organised in the form of co-operatives. Besides, a great number of banks including the saving banks and so-called State banks, historically have developed in the ownership of municipalities and federal states. These so-called public banks, in their business activities, compete with the private banks and are subject to the same general rules of contract law and tort liability as the others.

Neither the Civil Code nor the Commercial Code contain specific rules for the highly complex modern business activities of banks. Instead, the courts, when applying the general rules of the Civil and Commercial Codes, have developed many specific rules for contracts concluded by banks and their customers. It is this great number of court decisions and the legal commentaries digesting it that provides legal guidance for banking practice. The banks use general conditions of contract (Allgemeine Geschäftsbedingungen; AGB) in their business transactions and, at least in the great number of their credit and other contracts with customers, standardised form contracts. Both general conditions of contract and form con-

tracts are subject to the German Law on General Conditions of Contract that tend to protect a customer against surprising and unfair conditions.

The main features of the bank/customer relationship and its contractual basis are described below (*infra* chapter 6) together with the highly important question of prices and charges for banking services (chapter 7). With regard to credits of private customers, the German legislator tends to protect the customer against unclear and one-sided credit conditions through the Consumer Credit Law (Verbraucherkreditgesetz, VerbrKrG), which has been enacted in line with a directive of the European Community (*infra* chapter 8). To a large extent, business enterprises finance their business transactions through bank credits. Here, the availability of suitable credit securities and the relevant law that regulates them is of great importance (*infra* chapter 9).

IV. International Perspective

International perspectives and linkages of German banking law can be observed both in the realm of public banking law and private banking law. With regard to public banking law, Germany is among the first 11 participants of stage 3 of the European Monetary Union (chapter 3). As a Member of the European Community, it participates in the efforts to harmonise the laws and regulations on prudential supervision of banks and other financial service providers and on capital market transactions (*infra* chapter 5).

In the area of private law, we can observe partial harmonisation of law pertaining to consumer protection as the Consumer Credit Law within the European Community (*infra* chapter 5 and chapter 8). Other developments of harmonisation or even unification of law reach beyond the European Community and can be observed world-wide. Thus, German export business since long has been accustomed to use contractual patterns and clauses that largely follow internationally harmonised or standardised forms, as can be seen in the use of letters of credit (*infra* chapter 10) and bank guarantees (*infra* chapter 11).

Part One:

Public Law of Banking and Financial Markets

Chapter One

The *Deutsche Bundesbank* and its Legal Regime

Bernd Krauskopf

I. Introduction

The Central Bank plays an important role in a country's banking system. It supplies central bank money to credit institutions and the economy. In most cases, it has the sole right to issue banknotes with the status of legal tender. In many countries, the central bank also performs banking supervisory functions. The tasks, powers and organisation of central banks can differ very greatly from country to country. As the other chapters of this publication also show, the activities of banks and the banking law of any country depend crucially on the regulatory framework governing economic activities in that country.

That is especially true of the legal regime of the central bank. The structure and tasks of a central bank are the result of many previous political and economic decisions. This chapter covers diverse aspects. After outlining the organisation of the *Deutsche Bundesbank*, I would like to limit myself to a few key points concerning the legal regime of a central bank. What I mean by "legal regime" is its statutory mandate, its relationship with the government, and its set of money policy instruments. I will then conclude with a brief look ahead to the role of the *Deutsche Bundesbank* in the future European System of Central Banks in a European Monetary Union.

II. Organisation of the *Deutsche Bundesbank*

In its present form, the *Deutsche Bundesbank* was created in 1957. It is a public-law corporation based in Frankfurt am Main with a capital base of 290 million Deutsche Mark. The *Deutsche Bundesbank* is the successor organisation to the *Bank Deutscher Länder*, which was set up in 1948 (three years after the end of World War II) in connection with the introduction of the Deutsche Mark. The *Deutsche Bundesbank*'s tasks and organisation are regulated in the Bundesbank Act of 1957.

The *Deutsche Bundesbank* consists of a Central Office located in Frankfurt am Main and nine regional offices known as Federal State Central Banks. Each State Central Bank is responsible for one or more regional states in Germany. Thus, the *Deutsche Bundesbank* has a highly decentralised structure. This reflects the federal structure of Germany itself, which consists of sixteen regional states which each have local powers.

The supreme decision-making body of the *Deutsche Bundesbank* is the Central Bank Council. It consists of the President of the *Deutsche Bundesbank*, the Vice President, the other members of the Board, plus the nine Presidents of the State Central Banks. The Presidents of the State Central Banks are appointed by the German President at the suggestion of the *Bundesrat*, the Upper House of Parliament in Germany made up of representatives of the regional states. That is another federal element in the structure of the *Deutsche Bundesbank*.

The Board of the *Deutsche Bundesbank* is headed by the Bundesbank President. The Board has a Vice-President and six other members. The members of the Board are appointed by the German President at the suggestion of the Government. The period of office of the members of the Board consists of a minimum of two years and a maximum of eight years. After having served for eight years, it is possible for them to be reappointed for a second term of office. In principle, they cannot be removed from office before the end of their term. The same applies to the Presidents of the State Central Banks. That is a fundamental aspect of the Bundesbank's independence in terms of its leading personnel.

The Central Bank Council decides the Bundesbank's monetary and credit policy. It also issues guidelines on the conduct of the Bank's business and administration. As a rule, it meets one day every two weeks in Frankfurt under the chairmanship of the Bundesbank President or Vice-President. The Central Bank Council reaches its decisions by a simple majority.

The Board of the *Deutsche Bundesbank* runs and manages the Bank and is responsible for implementing the decisions of the Central Bank Council. Certain regional tasks are assigned to the State Central Banks to be performed on their own responsibility.

Here are a few figures on the *Deutsche Bundesbank*:

- The *Deutsche Bundesbank* has a total of 16,300 employees of which around 2,600 work at the Central Office and 13,700 at the State Central Banks.
- The *Deutsche Bundesbank* – or, to be more precise – the State Central Banks maintain 164 branch offices in the major cities. This branch network has a long-standing tradition in the German central banking system. However, for reasons of cost-effectiveness, the Bundesbank is currently being compelled to close smaller offices, so that the number of branch offices will continue to

fall. The main tasks of the branch network are the supply of banknotes and coins and the handling of cashless payments.

III. Central Bank Functions

The Bundesbank performs a number of typical central bank functions which have evolved over the years. Its monopoly on the issue of banknotes (Art. 14 of the Bundesbank Act) is the cornerstone of the Bundesbank's monetary policy powers and constitutes the real basis for its effective control over the expansion of the entire money stock, including deposit money.

The Bundesbank acts as the "banks' bank" by supplying the credit institutions with central bank balances on which they depend for their credit business. Unlike the pre-war *Deutsche Reichsbank*, the Bundesbank does not engage in direct lending to business and industry. In addition, the Bundesbank is the only holder of official monetary reserves. On August 31, 1997, the *Deutsche Bundesbank*'s monetary reserves amounted to around 114 billion Deutsche Mark.

The *Deutsche Bundesbank*, which is forbidden by the Maastricht Treaty to grant loans to the government, also plays an important role in helping the central Government and the regional state governments to borrow money in the capital market (Art. 20 of the Bundesbank Act). In this context, the Bundesbank mainly performs an advisory, intermediary and coordinating function, for which its knowledge of market conditions makes it especially fitted. For instance, the Bundesbank acts as the fiscal agent for most of the debt instruments issued by the Government.

The *Deutsche Bundesbank* also plays an important role in external monetary relationships. For example, the Bundesbank plays a central part in Germany's operational membership of the IMF. The Bundesbank President traditionally assumes the functions of the German Governor within the IMF.

IV. Objectives of Monetary Policy

An absolute key element of the legal framework of the *Deutsche Bundesbank* is the Bundesbank's primary mandate to ensure price stability. According to Art. 3 of the Bundesbank Act, the Bundesbank regulates the amount of money in circulation and of credit supplied to the economy, using the monetary powers conferred on it by the Act, *with the aim of safeguarding the currency*, and arranges for the execution of domestic and international payments. The aim of safeguarding the currency was regarded, and continues to be regarded, as a *mandate to safeguard the value of the currency, i.e. price stability.*

V. Independence of the *Deutsche Bundesbank*

Besides its commitment to maintain price stability, the independence of the *Deutsche Bundesbank* in relation to the Government is another fundamental element of the legal regime of the Bundesbank.

The Bundesbank's relationship with the Government, and hence with the aims of general economic policy, is governed by Art. 12 of the Bundesbank Act. This provision states that the Bundesbank is required to support the general economic policy of the Government, but without prejudice to the performance of its functions. The qualification "without prejudice to the performance of its functions" means that the main aim of the Bundesbank's monetary policy is to safeguard price stability. Only if this objective is not in danger may it also take account in its decisions of general economic policy, which is oriented not only to ensuring monetary stability but also to the goals of full employment and economic growth with balanced public finances. Hence if there is ever a conflict of economic policy objectives, the Bundesbank's top priority is always price stability. In the past four decades the Bundesbank has always made it very clear that it accepts the special responsibility for combating inflation which the law has given to it.

Art. 12 of the Bundesbank Act further stipulates that, in exercising the power conferred on it by the Act, the Bundesbank is independent of instructions from the Government. This freedom from government instructions is the key element of the Bundesbank's independence. Independence from government interference makes it much easier for a central bank to implement a monetary policy geared to stability, which is a necessary precondition for sustainable economic growth.

Another important aspect of central bank independence is the prohibition of, or at least a limit on, lending to public authorities. As I already mentioned, the Bundesbank is not allowed to lend to public authorities. As I also mentioned earlier, the Bundesbank's independence is strengthened by the fact that the members of the Central Bank Council are appointed for an eight-year term of office and in principle cannot be removed from office except for serious reasons. In the past four decades that has never happened.

VI. Cooperation between the Government and the *Deutsche Bundesbank*

However, the independence of the Bundesbank in conducting monetary policy does not mean that there is no cooperation between the Government and the Central Bank. In Art. 13, the Bundesbank Act provides the following institutional framework for cooperation between the Government and the Bundesbank:

- The Bank has a duty to advise the Government on monetary policy issues of major importance.

- The members of the Government are entitled to attend the meetings of the Central Bank Council. They have no right to vote, but may propose motions. In addition, the Bundesbank's statutes say that the Minister of Economics and the Minister of Finance are to be invited to attend every meeting of the Central Bank Council.
- Finally, the Government is obliged to invite the President of the *Deutsche Bundesbank* to attend its discussions of important policy issues.

In addition to the basic standard for cooperation laid down in Arts. 12 and 13, the Bundesbank Act contains a number of rules in matters relating to both operations and staff which give the Government some administrative influence over the Bundesbank outside its key monetary mandate.

There are also some rules on interaction outside the Bundesbank Act. The Banking Act, for example, regulates banking supervision. Finally, outside the context of formal cooperation there is an ongoing exchange of views between the Bundesbank and the ministries when new laws are being prepared.

VII. Cooperation with the Federal Banking Supervisory Office

In Germany, banking supervision is not the responsibility of the *Deutsche Bundesbank* but of a separate public authority, the Federal Banking Supervisory Office. Banking supervision in Germany and Europe will be explained in the following chapter. The only thing I would like to mention here already about the Bundesbank's role is that, in accordance with Art. 7 of the Banking Act, the *Deutsche Bundesbank* and the Federal Banking Supervisory Office cooperate closely.

VIII. Monetary Policy Instruments of the *Deutsche Bundesbank*

In order to be able to achieve its mandate of maintaining price stability, the *Deutsche Bundesbank* is armed with a set of monetary policy instruments, in line with the Bundesbank Act, designed to allow it to influence price movements. In view of their importance, I should explain more about the monetary policy instruments and its monetary policy strategy.

The set of monetary policy instruments and the monetary policy of the *Deutsche Bundesbank* are closely connected with the structure and method of functioning of the German economic system in general, and of the finance system in particular. On the one hand, the underlying conditions in the financial sector define the scope for and the limits to monetary policy action by the central bank. On the other hand, the Bundesbank's statutes and monetary policy define some basic conditions for the functioning and the longer-term development of the financial markets.

In the prevailing circumstances in Germany of an open market economy with fully liberalised capital and credit markets, the Bundesbank cannot control price

movements directly. The starting point of the Bundesbank's monetary policy is its monopoly on the issuance of banknotes. The aim of monetary policy is to influence the decisions on expenditure and prices of the non-banking sector by means of the interest rates it charges for central bank money, especially day-to-day money rates. The Bundesbank's monetary policy actions, directed at the money market, influence commercial banks' lending and deposit rates, capital market rates and exchange rates. From the money market, via a complex transmission process, these impulses affect non-banks' account management and, in the end, influence decisions about expenditure and prices.

The Bundesbank Act gives the Bundesbank a wide range of interest rate and liquidity policy instruments with which to perform its monetary policy functions. These enable the Bundesbank to influence interest rate terms and conditions and tensions in the money market in many different ways.

First, since the mid-eighties the implementation of monetary policy has centred on *open market operations* in the form of securities repurchase agreements, or "repos". They are the main channel for providing central bank funds. In these repo transactions the Bundesbank buys securities from credit institutions, subject to the proviso that they will repurchase them at a given date.

The legal mandate for repo business is Art. 21 of the Bundesbank Act, together with the general terms and conditions for repo transactions. The Bundesbank conducts repo business with all banks that are subject to minimum reserve regulations. This means that around 3,600 credit institutions have direct access to central bank refinancing. Since December, 1993, repo transactions have been held weekly, and the maturity is usually two weeks.

Secondly, one of the traditional refinancing instruments in Germany is bill-based lending, so-called *rediscount policy* (Art. 19, paragraph 1, no.1 of the Bundesbank Act). The Bundesbank purchases bills of exchange which satisfy certain requirements of financial soundness. The bills are rediscounted, that is they are bought at a discount. The discount rate that is charged on such business was regarded for a long time as the most important central bank interest rate of all. Since the discount rate has generally been below the overnight market rates for many decades, discount lending constitutes a form of privileged access to central bank money. For that reason, the amount of bills that can be purchased from individual credit institutions is restricted by quota.

Thirdly, *Lombard credit* (Art. 19, paragraph 1, no.3 of the Bundesbank Act) is the Bundesbank's marginal lending facility. With this instrument, the Bundesbank makes interest-bearing loans available to credit institutions against the collateral of certain securities or other financial instruments. These loans are known as lombard loans. The lombard rate acts as a kind of upper limit for the overnight market interest rate as part of flexible money market management. A look at the refinancing structure of banks shows that the share of securities repurchase agreements in overall refinancing is around two thirds, with bill-based lending

making up the remaining third. Nowadays, lombard credit accounts for less than 1 per cent.

Finally, obligatory *minimum reserves* (Art. 16 of the Bundesbank Act) were first introduced in Germany in 1948 with the currency reform that created the Deutsche Mark. The legal basis for the present minimum reserve regulations is Art. 16 of the Bundesbank Act. Under that provision the Bundesbank may require credit institutions to hold certain percentages of their liabilities in respect of short and medium-term borrowed funds in the form of non-interest bearing deposits at the Bundesbank. The Bundesbank Act sets the maximum ratios for the minimum reserves.

IX. Monetary Policy Strategy of the *Deutsche Bundesbank*

In order to be complete, one must mention the *monetary policy strategy* which the Bundesbank uses in trying to achieve its final objective of maintaining price stability.

Since the mid-seventies, the Bundesbank has oriented its monetary policy decisions to the trend in monetary growth. Each year it announces a monetary target in order to inform the general public, and as an orientation guide for the economic agents concerned. The practice of setting monetary targets is based on the experience that, in the medium term, inflation cannot escalate as long as money balances do not grow excessively. Besides the trend in monetary growth, the Bundesbank considers a whole range of other economic indicators when making monetary policy decisions.

From a legal point of view, the Bundesbank is free to choose the monetary policy strategy it considers most suitable in guiding its monetary policy decisions.

X. The *Deutsche Bundesbank* and the European System of Central Banks

The Bundesbank will be part of the *European System of Central Banks* in a future European Monetary Union. In 1992 the member states of the European Community decided to set up a European economic and monetary union in three stages. If the member states have achieved the necessary economic and legal convergence, it is planned that they will join in a monetary union on January 1, 1999. Responsibility for the monetary policy of the participating member states will then be transferred to the Community level. Responsibility for monetary policy will then lie with the European System of Central Banks, consisting of the European Central Bank and the national central banks of the participating member states.

Monetary union will fundamentally change the legal regime of the Bundesbank. In future, the *Deutsche Bundesbank* will no longer operate a monetary policy of its own; but instead will perform its functions in the main as a part of the European System of Central Banks.

Monetary policy decisions in the monetary union will be taken by the Governing Council of the European Central Bank. It will consist of the President, Vice President and members of the Executive Board of the European Central Bank as well as the Governors of the national central banks of the states participating in the monetary union.

The statute of the European System of Central Banks contains a legal regime which essentially corresponds very much to that of the *Deutsche Bundesbank*. The primary objective of the European System of Central Banks will be to ensure price stability. The ESCB will also support the general economic policies in the Community as long as that does not conflict with the goal of maintaining price stability (Art. 105, paragraph 1 of the ESCB Statute).

Art. 107 of the Treaty on European Union guarantees the independence of the European Central Bank and of the national central banks from instructions of European institutions or national governments. On the basis of this treaty, the European System of Central Banks will have a sufficient set of instruments to be able to perform its mandate of ensuring price stability. Open market transactions will be the main monetary policy tool of the ESCB, which will operate within a similar economic policy framework to that of the *Deutsche Bundesbank* (an open market economy with liberalised capital and credit markets).

The work of preparing the set of monetary policy instruments is not yet completed. The European Monetary Institute in Frankfurt am Main, together with the central banks of the European Union, are working at full pressure on the details. The European Monetary Institute is the forerunner of the European Central Bank, which will likewise be located in Frankfurt am Main.

Chapter Two

The Institutional and Legal Framework for the European Monetary Union (EMU)

Norbert Horn

I. The Treaty of Maastricht and Decisions for the EMU

1. The Decisions of 1992 and 1998

On February 7, 1992, the heads of state and government of the twelve Member States of the European Economic Community (EEC) convened in Maastricht, Netherlands, to sign the Treaty on the European Union[1] for the further development of the EEC, founded in 1957. The core of the Treaty of Maastricht are the provisions on the establishment of a European Economic and Monetary Union. The main goal and the main effect of this union are the introduction of a single European currency, the euro, and the establishment of a common European System of Central Banks (ESCB). Thus, it is justified to speak simply of a "European Monetary Union" (EMU).

On May 2, 1998, the heads of state and government of the eleven participating countries (i.e., Germany, France, Austria, the Netherlands, Belgium, Luxembourg, Finland, Ireland, Italy, Spain, and Portugal) decided to enter the third and decisive stage of the EMU, scheduled to start on January 1, 1999. Four of the fifteen members of the European Union remained outside: Great Britain, Sweden, and Denmark did not wish to participate at that time; and Greece did not qualify for membership.

The decision to begin stage 3 of the EMU followed a procedure prescribed by the Treaty of Maastricht. The Treaty lays down a procedure for deciding which countries would be allowed to participate in the single currency (Art. 109j, para. 4 ECT[2]). The E.U. Commission and the European Monetary Institute (EMI) had to

[1] Hereafter referred to as the "Treaty of Maastricht".

[2] Citations to "ECT" refer to the Treaty Establishing the European Community, as incorporated by the Treaty of Maastricht in Title II, Art. G.

report to the Council on "the progress made in the fulfillment by the Member States of their obligations regarding the achievement of economic and monetary union". This included, *inter alia,* reports on (a) the compatibility of the Member States' legislation, in particular regarding the statute of the Central Bank, and (b) the fulfilment of the so-called criteria of convergence, i.e., certain economic criteria to be met by the Member States to qualify for participation (*infra* Part III.1).

On the basis of these reports and a recommendation by the E.U. Commission, the Council, meeting in the composition of the ministers of economy and finance (ECOFIN), assessed for each Member State whether it fulfilled the necessary conditions for adoption of a single currency. This assessment was to be made by a qualified majority as defined in Art. 148 para. 2(1) ECT (62 votes out of 87 votes with no further requirements as to the number of countries). ECOFIN recommended its findings to the Council, meeting in the composition of the heads of state or government, which received an additional opinion by the European Parliament. Taking into account these reports and opinions, the Council then confirmed which Member States fulfilled the necessary conditions for the adoption of the single currency. This decision was to be made by a qualified majority with the additional requirement, however, that at least ten Member States cast their votes in favor.

The procedural law of the Treaty of Masstricht contains some ambiguities and open questions. The most important was whether the Treaty contained an automatic transition to stage 3. The Treaty states that the examination as to which countries met the convergence criteria was to be carried out, and if such examination was not made and a decision was not taken, the EMU irrevocably would start as of January 1, 1999. The question of whether there was an automatic transition built into the Treaty of Maastricht need not be answered, as the procedure for a decision was observed, and an affirmative decision was made. We can also leave open the strange question of whether a country could have been forced against its will to join the EMU after fulfilling the convergence criteria.

The latter question was discussed for some time in Germany, where many people were and still are concerned that a switch from the hard German mark to the euro will bring a loss of monetary stability. From the perspective of German constitutional law, the German government was free to decide whether or not to join. It was obliged to examine carefully the fulfillment of the convergence criteria by Germany and by the other countries joining EMU before reaching its decision. The German *Bundestag* (Lower House of the German Parliament), when it voted to adopt the Treaty of Maastricht on February 7, 1992, reserved its right to approve the entry into the third phase of the EMU on the basis of its own examination of whether or not the convergence criteria were met. The Federal Constitutional Court decided in October 1993 that under German constitutional law, there was no automatic transition with respect to Germany's participation in stage 3 of

EMU.[3] In May 1998, the German *Bundestag* voted in favor of participation in the EMU with the consent of all major parties including the social democrats, then the leading opposition party. A motion brought before the German Constitutional Court to enjoin the Government and Parliament from participating in stage 3 of the EMU was rejected by the Court.[4]

2. A Single Currency in 1999

The Maastricht Treaty states that the exchange rate parities between the participating countries are to be fixed irrevocably as of January 1, 1999. When the heads of state and governments made the decision on the transition to stage 3 of the EMU (Art. 109j(3) ECT) on May 2, 1998, they decided also on the parities between the national currencies of member countries relevant for the transition to the euro. The long used ecu[5] will play a key role when determining the external value of the euro on January 1, 1999. When stage 3 begins, the euro will become a currency in its own right (Art. 109l(4)1 ECT). A regulation of the E.U. Council on the transition to the euro defines the technical details.[6] The euro then replaces the participating national currencies at the fixed exchange rate. During a transition period of three years, the national currencies will still be in use, but only as sub-units of the euro, or as perfect substitutes (Art. 3, Council Regulation 974/98 on the introduction of the euro[7]). In other words, the national currencies of the participating states will be merely different denominations of the single currency. Official foreign exchange markets for the participating national currencies will disappear completely.

A May 1995 Green Paper of the European Commssion describes a transition scenario, which stresses the importance of generating rapid momentum for the introduction of the single currency by the immediate creation of a critical mass of activities conducted in euros.[8] This would require an initial change-over in the banking and financial sector, which would then have a maximum of three years to complete the change-over of remaining operations and systems.

[3] Decision of October 12, 1993, BVerfGE 89, 155ff.

[4] Decision of March 31, 1998, 1998 Neue Juristische Wochenschrift [NJW] 1934 (2 BvR 1877/97 u. 2 BvR 50/98).

[5] "European Currency Unit", as defined in Council Regulation (EC) No. 3320/94 of 22 December 1994 on the consolidation of the existing Community legislation on the definition of the ecu following the entry into force of the Treaty on European Union, 1994 O.J. (L 350) 27.

[6] 1996 O.J. (C 369) (draft).

[7] Council Regulation (EC) No. 974/98 of 3 May 1998 on the introduction of the euro, 1998 O.J. (L 139) 1.

[8] European Commission, Green Paper on the Practical Arrangements for the Introduction of the Single Currency (31 May 1995), Eur. Parl. Doc. (COM 95) 333.