



Study

How the Association Agreement between the European Union and Central America, and the Trade Agreement between the European Union on the one hand and Colombia and Peru on the other will affect the EU's planned regulatory reforms in the financial markets sector

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1. Introduction

This study explores how the Trade Agreement concluded between the European Union (EU) on the one hand and Colombia and Peru¹ on the other (hereinafter: Trade Agreement) and the Association Agreement concluded between the European Union and its Member States on the one hand and the Central American Republics of Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama² on the other (hereinafter: Association Agreement) might impact the regulatory reforms that Europe is planning for the financial sector.

2. To what extent might upcoming or mooted regulatory reforms in the financial sector conflict at German, European or international level with the stipulations which the European Union has made or wishes to make within the framework of free trade agreements?

2.1. The position of free trade agreements and association agreements within the EU legal order

The possibility of a relevant conflict between the agreements and the proposed regulatory reforms in the financial sector depends on the effects of the agreements within the EU legal order.

2.1.1. Legally binding effect of the agreements under EU law

Trade and association agreements have corresponding legal effects inasmuch as the contracting parties generally enter into reciprocal obligations. Association agreements within the meaning of Article 217 of the Treaty on the Functioning of the European Union (TFEU) generally establish between the EU and a third country links that go beyond mere trade agreements and that are characterised by the creation of special, privileged links with a third country, whereby the associated partner must, at least to a certain extent, take part in the EU system.³

Once the contracting parties have ratified the agreement in line with their respective procedures (for the EU, pursuant to Article 218(6) in conjunction with Article 218(8) TFEU), the other parties have been notified of the completion of this procedure and the contractual document has been filed, the agreement has legally binding effect under international law.⁴ In the case of mixed

1 Trade Agreement between the European Union and Colombia and Peru, Council document No 14757/11.

2 Agreement establishing an Association between the European Union and its Member States on the one hand, and Central America on the other, Council document No 16396/11; Proposal for a Council Decision authorising the signature and provisional application of the trade part (Part IV) of the Agreement establishing an Association between the European Union and its Member States on the one hand, and Central America on the other COM(2011)678 final.

3 ECJ, Case 12/86 (Demirel), para. 9.

4 Cf. Opinion of Advocate General Kokott, Case C-13/07 (WTO accession of Vietnam), para. 76 et seq, 88 et seq; established case law, cf. ECJ, Case 181/73 (Heagemann), para. 5; ECJ, Case 12/86 (Demirel), para. 7; ECJ, Case C-308/06 (Intertanko), para. 53; ECJ, Case C-301/08 (Bogiatzi), para. 23; ECJ, Opinion 1/91 (EEA I), para. 37.

international agreements ratified both by the EU and by the EU Member States, both the EU and the Member States are bound under international law and are directly obligated towards the contracting parties under international law.⁵

In addition, the provisions of such agreements have legal validity within the EU legal order. With regard to relations inside the EU, Article 216(2) TFEU provides that under EU law, agreements concluded by the Union are binding both upon the Union and upon the Member States. This binding legal effect under EU law occurs automatically when the agreement comes into force under international law – a separate transposition measure is not required.⁶ When the agreement comes into force under international law it becomes an integral part of the EU legal order.⁷ In the case of mixed agreements this direct validity takes effect for the Member States within the sphere of competence of the Member States under the responsibility of the national legal order.⁸

The agreement nevertheless retains its international character and is to be interpreted in accordance with rules of international law, so that the same legal term is to be interpreted according to different principles under rules of international law than under rules of EU law.⁹ Conversely, even if they have been concluded as mixed agreements, trade agreements may be used for interpretation of autonomous secondary Community legislation in conformity with international law.¹⁰ However, at the stage of recommendation and issue of the mandate for negotiations, the Council and the Commission are already responsible for doing everything possible to ensure that the trade agreement is compatible with the EU legal position (second sentence of Article 207(3)(2) TFEU). The European Court of Justice (ECJ) is responsible for monitoring whether international EU agreements are compatible with EU law and vice versa.

2.1.2. Direct applicability of the agreements

When free trade agreements or association agreements come into force under international law they generally have direct application within the EU legal order.¹¹ A transposition measure is not necessary. The direct legal applicability of the agreements within the EU legal order results from the duty of Member States towards the Union under Article 216(2) TFEU to comply with the commitments arising out of the agreement.¹² This also expresses the EU's obligation as a

5 Cf. ECJ, Case C-149/96 (Portugal/Council).

6 Established case law; cf. ECJ, Case 181/73 (Heagemann), para. 5; ECJ, Case 12/86 (Demirel), para. 7; ECJ, Case C-301/08 (Bogiatzi), para. 23; ECJ, Opinion 1/91 (EEA I), para. 37.

7 Established case law; cf. ECJ, Case 181/73 (Heagemann), para. 2, 6; ECJ, Case C-162/96 (Racke), para. 41.

8 Cf. ECJ, Joined Cases C-300/98 and C-392/98 (Parfums Christian Dior), para. 48. In relation to the direct effect of international legal provisions within the exclusive competence of the Member States within the German legal order cf. Kirsten Schmalenbach, in: Calliess/Ruffert, EUV/AEUV, 4th edition 2011, Article 216 TFEU, para. 44.

9 ECJ, Case 270/80 (Polydor), para. 15 et seq.; ECJ, Opinion 1/91 (EEA I), para. 14.

10 ECJ, Case C-53/96 (Hermès), para. 28; ECJ, Case C-61/94 (International Dairy Arrangement), para. 52.

11 ECJ, Case 104/81 (Kupferberg), para. 17; ECJ, Case C-149/96 (Portugal/Council), para. 34.

12 ECJ, Case 104/81, Kupferberg, para. 11, 13.

community governed by the rule of law to safeguard the protection of rights conferred on individuals by international agreements of this kind.¹³ In every case there must be bona fide performance of the commitments under the agreement, and each party is responsible for executing fully the commitments which it has undertaken. In doing so, each contracting party is free to determine the means appropriate for attaining that end in its legal system unless the agreement itself specifies those means.¹⁴

The effects which trade agreements have in the EU legal order result from Community law. As “acts” of the Community institutions, the international agreements concluded by the EU are indeed secondary Community legislation but they have primacy over autonomous Community law¹⁵. The conformity of existing secondary legislation with trade agreements is produced in this way in cases of conflict; in accordance with Article 216(2) TFEU the international agreements concluded by the EU are *binding under EU law* upon the Union and the Member States, and the agreements become an “integral part of the Community legal order” irrespective of the nature of the intra-Community act concluding the agreement:¹⁶ trade agreements are based on acts of the EU institutions and are therefore secondary EU legislation, although they have primacy over autonomous secondary EU legislation. Trade agreements share in the primacy of Community law over the law of the Member States. As an “integral part of the Community legal order”, free trade agreements or association agreements share in the primacy of EU law over conflicting provisions of national legislation of the Member States.¹⁷ The agreements concluded by the European Union are also binding on its institutions and therefore have primacy over secondary EU legislation and legal measures by the EU.¹⁸ On account of its primacy over secondary EU legislation, the validity of an EU legal measure can be affected if it is incompatible with such rules of international law. However, the validity of a Union rule under secondary law can be examined in the light of an international treaty only where the nature and structure of the latter do not preclude this and, in addition, where the treaty’s provisions appear, as regards their content, to be unconditional and sufficiently precise.¹⁹ Thus, for example, given their nature and the way they are organised, World Trade Organisation (WTO) agreements are not among the rules that the ECJ will use to review the legality of measures adopted by the EU institutions. The legality of an EU measure can, however, be examined in the light of a provision of the agreement where the Union has intended to implement a particular obligation assumed in the context of the WTO, or where the

13 Cf. Opinion of Advocate General La Pergola, Case C-262/96, para. 6.

14 ECJ, Case 104/81 (Kupferberg), para. 18.

15 ECJ, Case C-280/93 (Germany/Council), para. 105.

16 ECJ, Case 104/81 (Kupferberg), para. 18.

17 ECJ, Case 17/81 (Pabst and Richarz), para. 27.

18 Established case law; cf. ECJ, Joined Cases 21/72-24/72 (International Fruit Company), para. 6; ECJ, Case C-61/94 (Commission/Germany), para. 52; ECJ, Case C-280/93 (Germany/Council), para. 111; Case C-228/06 (Soysal and others/Germany), para. 59; ECJ, Case C-366/10 (Air Transport Association), para. 50; ECJ, Case C-311/04 (Algemene Scheeps Agentuur Dordrecht), para. 25; ECJ, Case C-308/06 (Intertanko), para. 42, ECJ, Joined Cases C-402/05 P and C-415/05 P (Kadi and others/Council and Commission), para. 307.

19 Cf. among others ECJ, Case C-308/06 (Intertanko), para. 45.

Union measure refers expressly to a precise provision of the agreement.²⁰ The validity of an EU legal measure can only be examined in the light of the relevant rules of international law if the EU is bound by those rules,²¹ if the nature and structure of the agreement do not preclude such a review²² and if the invoked provision appears, as regards its content, to be unconditional and sufficiently precise in the sense that it contains a clear obligation which is not subject, in its implementation or effects, to the adoption of any subsequent measure.²³

At any event, therefore, acts of the EU institutions are not to be examined in the light of the provisions of the agreement if the agreement leaves wide scope for manoeuvre in relation to performance of the objectives of the agreement and if the agreement does not contain a mutual obligation in relation to implementation.²⁴ In this case the rules of the agreement must be taken into account “as far as possible” in the application of EU law, i.e. the EU law must be interpreted in a manner that is pro international law.²⁵

However, from the perspective of EU law, agreements do not have primacy over primary legislation,²⁶ although from the perspective of international law this does not affect the validity of a commitment undertaken that is potentially contrary to EU law (Article 46 of the Vienna Convention on the Law of Treaties (VCLT)).²⁷ However, agreements that are concluded in violation of primary and secondary EU legislation remain binding upon the Union and must therefore be terminated or amended.²⁸

A direct effect is neither excluded by reason of the fact that the agreement contains non-reciprocal provisions in favour of the associated partner, nor by reason of the fact that recognition

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- 20 Cf. ECJ, Case C-377/02 (Van Parys), para. 20, and the statement by the ECJ in Case C-307/99 (OGT Fruchthandelsgesellschaft), para. 28: “...the common organisation of the market in bananas, as introduced by Regulation No 404/93 and subsequently amended, is not designed to ensure the implementation in the Community legal order of a particular obligation assumed in the context of GATT, nor does it refer expressly to specific provisions of GATT.”
- 21 ECJ, Case C-308/06 (Intertanko), para. 43 et seq; ECJ, Joined Cases 21/72-24/72 (International Fruit Company), para. 7.
- 22 ECJ, Case C-120/06 P and C-121/06 P (FIAMM and others/Council and Commission), para. 110.
- 23 ECJ, Case C-213/03 (Pêcheurs de l'étang de Berre), para. 39; ECJ, Case C-308/06 (Intertanko), para. 45; ECJ, Case C-344/04 (IATA and ELFAA), para. 39; ECJ, para. C-240/09 (Lesoochránárske zoskupenie), para. 44.
- 24 ECJ, Case C-149/96 (Portugal/Council), para. 36 et seq. and 45; ECJ, Case C-377/02 (Léon Van Parys), paras. 49–53; ECJ, Case C-210/06 P and C-121/06 P (FIAMM and FIAMM Technologies), para. 117.
- 25 ECJ, Joined Cases C-300 and 392/98, (Parfums Christian Dior SA), para. 47; ECJ, Case C-53/96 (Hermès), para. 28; ECJ, Case C-245/02, (Anheuser-Busch), para. 55; ECJ, Case C-431/05, (Merck Genéricos-Produtos Farmacêuticos), para. 35; ECJ, Case 428/08, (Monsanto Technology), para. 72; ECJ, Case C-373/08 (Hoesch Metals und Alloys GmbH), para. 40.
- 26 ECJ, Joined Cases C-402/05 P and C-415/05 P (Kadi and others/Council), para. 308.
- 27 On the avoidance of conflicts cf. the opinion procedure pursuant to Article 218(11) TFEU.
- 28 ECJ, Case C-327/91 (France/Commission), para. 41 et seq; ECJ, Joined Cases C-317/04 and 318/04 (Parliament/Council), para. 71 et seq.

of a direct effect is not based on reciprocity.²⁹ If a direct effect of the agreement is to be excluded, a specific provision to this effect must be reached in the agreement itself or in the Council's decision approving the agreement.³⁰ The contracting parties may agree what effects the provisions of an agreement are to have in the internal legal order of the contracting parties.³¹ Accordingly, the ability of an EU Member State or EU institution to invoke the provisions of an EU agreement to challenge the validity of secondary legislation does not depend solely on the agreement forming an integral part of the EU legal order, but also on the effect that the EU and the contracting parties intend the agreement to have in the EU legal order. If this intention is not clear, the ECJ, which is responsible for deciding the legal effect of the agreement in the EU legal order, approaches this question by interpreting the agreement in question and taking account of structure, language and purpose.^{32 33}

2.1.3. Direct effect of the agreement

Individual rules of trade agreements can take direct effect beyond the binding force of the agreement, with the consequence that persons may invoke these before courts and authorities insofar as the legal nature and the organisation of the agreement does not preclude this and insofar as the specific rule is unconditional and sufficiently precise.³⁴ According to the established case law of the ECJ, international legal provisions that are directly applicable in the EU legal order can create subjective rights for individuals wherever, taking account of their wording and having regard to the spirit and purpose of the agreement, these provisions contain a clear and precise obligation which is not subject, in its implementation or effects, to the adoption of any subsequent measure.³⁵ For the agreement to have a direct effect protecting individuals, it is a prerequisite, based on the nature, general scheme and wording of this agreement, that the persons subject to the EU law are entitled to question the validity of a Community act before the courts in reliance on an international agreement.³⁶ Moreover, natural or juridical persons can

29 ECJ, Case C-162/00 (Pokrzeptowicz-Meyer), para. 27; ECJ, Case 104/81 (Kupferberg), para. 27.

30 ECJ, Case 104/81 (Kupferberg), para. 17.

31 ECJ, Case C-149/96, (Portugal/Council), para. 34; ECJ, Case C-210/06 P and C-121/06 P, (FIAMM and FIAMM Technologies), para. 108.

32 Kirsten Schmalenbach in: Calliess/Ruffert, EUV/AEUV, 4th edition 2011, Article 216 TFEU, para. 29 with references to ECJ, Case C-280/93, para. 105 et seq. (Federal Republic of Germany/Council); Case C-149/96, paras. 35 and 41 (Portugal/Council).

33 ECJ, Case 104/81 (Kupferberg), para. 17; ECJ, Case C-280/93 (Germany/Council), para. 110.

34 ECJ, Case 194/81 (Kupferberg), para. 22 et seq.

35 ECJ, Case C-37/98 (Savas), para. 39; ECJ, Case C-262/96 (Sürül), para. 60; ECJ, Case C-416/96 (Eddline El-Yassini), para. 25; ECJ, Case C-432/92 (Anastasiou), para. 23; ECJ, Case 469/93 (Chiquita), para. 57 Italia).

36 ECJ, Joined Cases 21/72 to 24/72 (International Fruit Company), para. 19.

only invoke the provisions of the agreement if, in light of the legal nature and the organisation of the agreement, the individual provisions are sufficiently precise and unconditional.³⁷

2.2. Conclusion

On the basis of the foregoing criteria it is possible that the Trade Agreement or the Association Agreement will produce legal effects for the EU legal order and thus for the planned secondary legislative reforms in the financial markets sector. Both the EU and the Member States are contracting parties to the Association Agreement; in the case of the Trade Agreement the EU is the contracting party. On the basis of the foregoing criteria, the EU and the Member States are bound under international law and EU law by the provisions of the Agreement. When the Trade Agreement comes into force its provisions become an integral part of the EU legal order. The nature and structure of the Trade Agreement (establishment of a free trade zone) do not preclude that it could have the effect of establishing criteria in respect of the validity of planned secondary legislative reforms in the financial sector. Accordingly, it is also possible that the planned regulatory reforms in the financial markets sector contravene the higher-ranking commitments under the free trade agreement. For instance, the Trade Agreement is designed to facilitate the establishment of clear and mutually advantageous rules governing trade, to foster trade and investment between the parties and to make their companies more competitive on international markets by providing a reliable legal framework for their trade and investment relations (9th and 10th recitals and Articles 3 and 4 of the Trade Agreement). The Agreement is specifically aimed at economic operators established in the territory of the contracting parties. For example, with regard to capital account transactions and balance of payments transactions, the contracting parties are to ensure the free movement of capital relating to direct investments in juridical persons founded in accordance with the laws of the host country (Article 169 of the Trade Agreement). The Trade Agreement thus introduces regulations that apply directly to specific market participants and that are intended to give them rights which may be asserted against the contracting parties.

3. Which stipulations in free trade agreements on financial market liberalisation and freedom of establishment could undermine which planned regulatory reforms?

As far as can be seen, the foregoing criteria show that a direct effect of the provisions of the agreement cannot be excluded in advance or on a regulatory or sector-specific basis. However, a specific review is needed in individual cases and, in particular, in the context of the regulatory content of the planned financial market regulatory reforms to assess whether the provisions of the agreement have a direct effect. In this respect, on the basis of the current status of the regulatory reforms, this study only identifies a possibility in principle, not an actual possibility, that the provisions of the agreement could influence the following financial-sector regulatory

37 ECJ, Case 104/81, Rn. 22 f. (Kupferberg); ECJ, Joined Cases C-300 and 392/98 (Parfums Christian Dior SA). para. 42.

reforms³⁸, the regulatory content of which exhibits potential connections to the Trade Agreement and to the Association Agreement:³⁹

- Proposed Regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions⁴⁰
- Proposed Regulation amending the Regulation establishing a European Banking Authority⁴¹
- Proposed Regulation relating to the Directive concerning Commission Delegated Regulation supplementing Directive 2011/61/EU⁴² of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision.⁴³
- Directive on Alternative Investment Fund Managers (AIFM Directive)⁴⁴
- Regulation on OTC derivatives, central counterparties and trade repositories (European Market Infrastructure Regulation, EMIR)⁴⁵

38 Cf. the overview at http://ec.europa.eu/internal_market/finances/policy/index_en.htm.

39 This also applies to the question of how far the stipulation on financial services in Part IV (Trade), Chapter III (Establishment, Trade in Services and Electronic Commerce) and Annex X of the Association Agreement between the EU and Central America could undermine the planned regulatory reforms.

40 Proposal for a Council Regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, COM(2012)511 final, available online at: http://ec.europa.eu/internal_market/finances/docs/committees/reform/20120912-com-2012-511_en.pdf; cf. in this regard the Roadmap towards a Banking Union, Communication from the Commission to the European Parliament and the Council: A Roadmap towards a Banking Union, COM(2012)510 final, available online at: http://ec.europa.eu/internal_market/finances/docs/committees/reform/20120912-com-2012-510_en.pdf.

41 Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority) as regards its interaction with Council Regulation (EU) No .../... conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, COM (2012)512 final, available online at: http://ec.europa.eu/internal_market/finances/docs/committees/reform/20120912-com-2012-512_en.pdf.

42 Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010.

43 Proposed Commission Regulation of 19.12.2012, COM(2012)8370 final.

44 Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010, Official Journal (OJ) L 174 of 01.07.2011, p. 1.

45 Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, OJ L 201 of 27.7.2012, p. 1.

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- Regulation of a deposit guarantee system⁴⁶
 - Regulation of an integrated banking crisis management system⁴⁷
 - Reform of markets in financial instruments⁴⁸
- 4. What is the possibility that uncovered short selling of shares, bonds and credit default swaps, which has been prohibited in the EU since November, will happen within the framework of the Association Agreement on Central America?**

As the criteria above show, international agreements made by the EU or mixed agreements made by the EU and its Member States can affect secondary legislation. The Regulation on short selling and certain aspects of credit default swaps⁴⁹ is not excluded from this effect. Assessment of this possibility, as well as the resulting implications, is a question of legal policy and not a question of the legal assessment of the agreement and its relationship to EU law.

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46 Commission proposals for a Capital Requirements Directive (CRD IV Directive) of 20.07.2011, COM(2011)453; for a Capital Requirements Regulation (CRD IV Regulation) of 20.07.2011, COM(2011)452; and for a Directive on the harmonisation of deposit guarantee schemes of 12.07.2010, COM(2010)368.

47 Commission Proposal for a Directive establishing a framework for the recovery and resolution of credit institutions and investment firms, COM(2012)280 final.

48 Proposal for a Directive of the European Parliament and of the Council on markets in financial instruments repealing Directive 2004/39/EC of the European Parliament and of the Council, COM(2011)656 final.

49 Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps, OJ L 86/1.