

Banking - Austria

Constitutional Court challenges EU directive's conflict of interest provisions

Contributed by Binder Grösswang Rechtsanwälte GmbH

March 01 2013

[Introduction](#)

[Facts](#)

[Decision](#)

[Comment](#)

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Introduction

Among other activities, trading in securities and other financial instruments - whether on a bank's own account or on behalf of its clients - constitutes 'banking business' under Section 1(1) of the Federal Banking Act. Such activities are also subject to the Securities Supervision Act, which was amended to transpose the EU Markets in Financial Instruments Directive (2004/39/EC, as amended) into Austrian law. Articles 13 and 18 of the directive, on conflicts of interest, were introduced into the Securities Supervision Act. The Financial Market Authority (FMA) also issued a regulation to implement Article 22(3)(2) of EU Directive 2006/73/EC. The legislature and the FMA copied the respective texts of the directives verbatim into the pieces of legislation.

Those provisions require, among other things, that the bank establish, implement and maintain an effective conflicts of interest policy, set out in writing, that is appropriate to its size and organisation and the nature, scale and complexity of its business. The bank must also specify the procedures to be followed and measures to be adopted in order to manage conflicts of interest.

Following concerns over the legality of the new laws, the Constitutional Court was asked to review the relevant provisions.

Facts

The managing directors of a bank engaged in the trading of securities on behalf of clients and for proprietary purposes had been fined by the FMA for not having properly observed the policies set up for the avoidance of conflicts of interest. In particular, the trades for both spheres were executed by the same persons and the people dealing with clients' and the bank's orders were not separated by constructional measures (not only so-called 'Chinese walls', but real walls would have been necessary). The bank appealed, but lost, before the appellate senate, which confirmed the FMA's decision with minor changes, stating that the bank had failed to uphold the requirement for a separation by constructional measures, as they were not contained in its internal conflicts of interest policy.

The directors brought the issue before the Constitutional Court, arguing that the respective provisions of the Securities Supervision Act (which are identical to Article 22 of the EU Markets in Financial Instruments Directive) were unconstitutional on several grounds.

Decision

The court reviewed the act and the pertinent regulation in relation to their compatibility with the legality principle of the Constitution. The court spotted two reasons as to why those provisions may be unconstitutional.

First, the court found the provisions to be vague - not only in relation to the description of the requirements that warrant the adoption of a policy in order to avoid conflicts of interest, but also in the definition of the measures as such. However, the court had no problem in accepting that the term 'conflict of interest' was sufficiently clear, as in its view the concerned community has a pretty good picture of what those conflicts are.

The court's second argument related to the technique through which policies become binding - the court stated that the norms on which fines are based must be generated

through the involvement of a supervising authority. As such norms fill gaps left open by statute, if they are issued merely by the person that must obey them, this would breach principles of legality; instead, they should at least be approved by the regulator to ensure legal certainty in cases where breaches are penalised through fines.

Comment

The court has not yet abolished the incriminating provisions, but it often follows the arguments given in the resolution in relation to a review of constitutionality when it considers a case in plenary session. It is therefore likely that the legislature will get a second chance to transpose the provisions of the EU Markets in Financial Instruments Directive on conflicts of interest into Austrian law.

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