

# EU Financial Services BRIEFING



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## 1. Council Approval of the Reinsurance Directive

On 17 October, the Council adopted the Directive on Reinsurance (2005/68/EC). The Directive was published in the Official Journal on 9 December.

It follows the framework adopted for direct insurance by requiring home Member State authorisation and providing for a single passport for EU operations.

The Directive applies, wholly or partly, to all undertakings conducting reinsurance business, including captive reinsurers. It provides for:

- minimum conditions for obtaining authorisation e.g. a specific legal form, a scheme of operations, etc.;
- home Member State's sole responsibility for financial supervision;
- supervisory powers in cases of financial deterioration, inadequacy of technical provisions or insufficient solvency; and
- solvency provisions, including a minimum guarantee fund of €3 million.

Reinsurance undertakings already authorised before 10 December 2005 are deemed to be authorised for the purposes of this Directive, but they will be subject to certain provisions of the Directive, particularly regarding technical provisions, solvency and the guarantee fund, as of 10 December 2007.

The Directive also updates the Life, Non-Life and Insurance Groups Directives in line with the supervision rules for reinsurance undertakings.

**Timeline:** Member States must implement the Directive by 10 December 2007. Member States may grant an additional two years to reinsurers authorised before implementation.

## 2. Commission Consultation: Evaluation of the FSAP

On 7 November, the Commission published an evaluation report on the adoption of the various legislative and non-legislative Financial Services Action Plan ("FSAP") measures. The report is limited to the 42 measures included in the

original FSAP and the legislative and non-legislative measures connected to these that were adopted between 1999 and 2004. It attaches three annexes with:

- key dates in the adoption of FSAP measures;
- the state of play as at 15 October 2005 of transposition of the FSAP measures; and
- methods of consultation on FSAP measures.

The Commission has requested stakeholders' views on the FSAP process, including general perception, consultation, the Lamfalussy process and lessons learned.

The evaluation is the first part of a response to the call for an analysis of the impact of the FSAP. Part II will be carried out between 2006 and 2008 when all the FSAP measures have been implemented in the Member States and will deal with the impact of the measures.

***Timeline:** The deadline for replying to the consultation is 31 January 2006. The final Part I Report will be presented in April 2006.*

### 3. Commission Analysis of Obstacles to cross-border Mergers

On 8 November, the Commission presented to the ECOFIN Council its preliminary analysis of the reasons for the low level of pan-European restructuring in the financial services industry. The Commission's analysis, presented in the form of a working paper, consists of three parts:

- Part I: Cross-border consolidation within the EU financial sector between 1999 and 2004;
- Part II: Obstacles to cross-border consolidation identified by market participants (in accordance with contributions to an open survey conducted in April 2005); and
- Part III: Emerging issues (including the key issues raised by the obstacles identified).

The lack of cross-border cost synergies is identified as the major obstacle to consolidation. The supervisory approval process for the acquisition of qualifying shareholdings in banks (Article 16 of the EU Banking Directive (2000/12/EC)) is also seen as an obstacle, in addition to an unfavourable environment for

conducting cross-border transactions, the reluctance of consumers to buy and employees' suspicion of non-domestic companies.

An annex laying out the survey's results accompanies the Commission's working document.

On 21 October, the Commission also published an Interpretative Communication entitled "Intra-EU Investment in the Financial Services Sector". The Communication's objective is to remind national authorities and the private sector of how the basic Treaty freedoms of capital movements and establishment apply in the financial sector.

***Timeline:** The Commission's analysis will help clarify the steps required to tackle the problems identified. However, no concrete decisions have been taken yet. A Commission proposal on the revision of Article 16 of the Banking Directive (2000/12/EC) is expected before summer 2006.*

### 4. Commission's 2006 Work Programme

On 25 October, the Commission published its legislative and work programme for 2006. The document sets out major political priorities and identifies legislative initiatives, executive and other acts that the Commission intends to adopt for the achievement of these priorities.

The 2006 work programme is entitled "Unlocking Europe's full potential" and identifies: prosperity; solidarity; security; Europe as a world partner; and delivery and better regulation; as the major political priorities for 2006. Its list of priority items for adoption includes, among others, the following:

- White Paper on the integration of the EU mortgage credit market;
- White Paper on the next steps towards an efficient investment fund market;
- Directive on clearing and settlement in the securities field;
- Proposal to review Article 16 of the EU Banking Directive (2000/12/EC) (review of the supervisory approval process for major shareholdings);
- Decision on the renewal of a Community programme to improve the operation of taxation systems in the internal market

(Fiscalis 2013);

- Communication to the Council and the European Parliament on a strategy to improve measures against tax fraud; and
- Green Paper on Enforcement, including a European system for the attachment of bank accounts.

**Timeline:** *The above items have been described as priority by the Commission and are expected to be adopted in the course of 2006.*

## 5. Consultation on cross-border Payments in Euros

On 19 October, the Commission published a working document on the application of Regulation 2560/2001 on cross-border payments in euro (Article 8 of the Regulation which requires the Commission to prepare a report on its application). The Commission also intends to undertake a comprehensive evaluation of the impact of the Regulation in order to decide whether any amendments are required to bring it up to date. The review may also lead to infringement proceedings.

The working document outlines the information gathered to date by the Commission, i.e. on implementation problems, direct and indirect impact of the Regulation, etc. The Commission has also published a report prepared on its behalf entitled "Study of the Impact of Regulation 2560/2001 on Bank Charges for National Payments".

**Timeline:** *Replies to the consultation must be received by the Commission by 6 January 2006. They will be used to draft an Evaluation Report on which an open consultation will take place in the first half of 2006.*

## 6. Commission adopts White Paper on Financial Services Policy

On 5 December, the Commission published its White Paper on Financial Services Policy 2005-2010. This paper follows consultation on the Green Paper of 3 May.

The key priorities are as follows:

- "dynamic consolidation" of progress in integration of EU financial markets, by completing unfinished business, improving supervisory convergence and removing

remaining economically significant barriers;

- transparent and evidence-based policymaking, through, in particular, consultation, impact assessment and ex post review; and simplification, codification and clarification of existing legislation;
- improve supervisory cooperation and convergence. The focus is on making the Lamfalussy process work; deepening cooperation and exchange of information between home and host State supervisors; and developing a pan EU supervisory culture;
- future developments: the Commission is considering a proposal on clearing and settlement; it is also considering steps to reduce barriers to cross border consolidation, and whether to introduce a proposal on insurance guarantee schemes. The Commission doubts the benefits of a "26<sup>th</sup> regime", and confirms no plans for legislation on: rating agencies and financial analysts; measures on offer documents under the Takeover Bids Directive; and capital requirements for regulated markets.

The Commission will seek to improve the UCITS Directives, to ensure smoother operation of the UCITS passport, clarification of investment limits and consistent implementation. Finally, the Commission will review barriers to cross border bank accounts, and will investigate the area of credit intermediaries; and

- play a significant role in setting standards and best practice at a global level, and opening global financial services markets, and in combating financial crime.

**Timeline:** *The timetable for the various initiatives is set out in the White Paper.*

## 7. Commission commences Infringement Procedure against Italy

On 14 December, the Commission announced its decision to send a letter of formal notice to Italy, the first stage of infringement procedures under Article 226, EC Treaty.

This step follows the attempted takeover of two Italian banks, Banca Nazionale del Lavoro and Banca Antonveneta, by Banco Bilbao Vizcaya Argentaria and ABN AMRO respectively, both incorporated in other Member States.

The Commission is concerned that the regulatory framework for supervisory decisions (by the Bank of Italy) in this regard may give rise to procedural opacity and legal uncertainty. In addition, specified criteria for the appreciation of prudential acceptability may be lacking and could give rise to arbitrary decisions on authorisation.

Accordingly, the Commission considers that authorisation provisions as applied by the Bank of Italy may breach freedom of capital movements and establishment rights within Articles 56 and 43 EC Treaty.

**Timeline:** *Italy is invited to send its observations to the Commission; if the Commission considers these insufficient to address its concerns, it may issue a reasoned opinion. The recent resignation of the Bank's governor, Mr Fazio, does not affect this procedure, since it is opened against the Member State, not the governor or the Bank.*

## 8. Parliament votes to approve Proposal on Accounting Rules

On 15 December, the European Parliament adopted a report on the proposed Directive amending Directives 78/660/EEC and 83/349/EEC on annual accounts of certain types of company. The proposed Directive is intended to:

- enhance transparency of off balance sheet arrangements and of related parties' transactions. The Parliament's amendments in this respect are intended to prevent excessive and costly disclosure;
- establish collective responsibility of board members regarding the accounts. The Parliament stresses there is no extension of directors' liability; and
- introduce a corporate governance statement for listed companies. The Parliament reduces the amount of information proposed for such a statement.

The proposal also removes certain inconsistencies between the Accounting Directives and IAS 39. In addition, it increases the thresholds for small companies and medium-sized companies by 20%.

The Parliament extends the title of the proposal to cover specifically the annual and consolidated accounts of banks and other financial institutions (Directive 86/635/EEC) and insurance undertakings (Directive 91/674/EEC).

**Timeline:** *It is intended that this proposal should be agreed at first reading.*

## 9. Developments in Lamfalussy Committees

On 24 November, the three Lamfalussy committees, CESR, CEBS and CEIOPS signed a protocol to deepen their coordination and cooperation in regulatory, policy, information exchange and other matters.

Other developments:

### CESR

- On 20 October, CESR published a second consultation paper on its draft advice to the Commission regarding clarification of definitions of eligible assets for UCITS. As part of this consultation, CESR organised a public hearing on 7 November. Consultation closed on 21 November. CESR will publish its final advice in mid-January 2006.
- On 27 October, CESR launched a consultation on simplifying the cross-border notification procedures under the UCITS Directive (Directive 85/611). An open hearing will be held on 17 January 2006 to consider draft guidelines; the consultation closes on 27 January.
- On 27 October, CESR published its final advice to the Commission on possible amendments to the Prospectus Directive (Directive 2003/71), to clarify the treatment of complex financial information.
- At the same time CESR published final advice to the Commission on amending historical information requirements for prospectuses, as required by Commission Regulation 809/2004.
- On 3 November, CESR published a recommendation on alternative performance measures.

### CEBS

- On 1 November, CEBS published its first set of guidelines for supervisory authorities on increased transparency and public disclosure, as required by the Capital Requirements Directive.

- On the same date CEBS published a supplementary note to its June 2005 consultation paper on the recognition of external credit assessment institutions (ECAIs). CEBS plans to approve its final guidelines on the recognition of ECAIs in January 2006, for publication in February 2006.
- On 15 November, CEBS published an on-line questionnaire to market participants to assist in its advice to the Commission on the definition of own funds. Responses are required by 10 February 2006.
- On 1 December, the Commission published its fifth call for advice to CEBS, on large exposures under the Capital Requirements Directive.
- On 16 December, CEBS published guidelines on a standardised financial reporting framework for credit institutions, designed to reduce, through convergence of supervisors' requirements, the burden of reporting in cross border environments.

#### CEIOPS

- CEIOPS issued, on 27 October, a second draft protocol on the collaboration of Member State competent authorities regarding the application of the IORP Directive (Directive 2003/41), in the light of the responses received to its initial consultation last February. The closing date for responses was 28 November.
- On 31 October, CEIOPS issued a Recommendation on possible need for Amendments to the Insurance Groups Directive. It recommends: that supervisors be able to require third country group reorganisation, e.g. through the creation of a holding company within the EEA; that certain amendments be introduced to improve cooperation between supervisors and promote a level playing field; no changes to reporting of transactions, but greater guidance.
- On 1 November, CEIOPS issued Answers to the Commission on the second wave of Calls for Advice in the framework of the Solvency II project. On 9 December, it issued its fourth progress report to the Commission on its work on Solvency II. At the same time it issued Consultation Paper 9: draft Answers to the third wave Calls for Advice (responses due 9 February 2006).

- Further consultations are: Consultation Paper 10, Draft medium term work programme; Paper 11, Draft recommendation on the independence and accountability of the supervisory review process; Paper 12, Treatment of deeply subordinated debt.

## 10. Other recent Developments

Publications by the European Commission over the last two months include:

- an invitation for public replies to a questionnaire on anti money-laundering obligations in non-face to face transactions and possible implications for electronic commerce in the context of the second anti-money laundering Directive;
- a report on the Commission's Open Hearing on investment funds;
- Commission Regulation 1864/2005 amending Regulation no 1725/2003 adopting certain international accounting standards in accordance with Regulation no 1606/2002. The new Regulation eliminates the fair value carve-out in IAS 39, and also amends IFRS 1 and IAS 32. The carve-out for hedge accounting remains. The measure has retroactive effect, from 1 January 2005;
- a note to the members of the European Insurance and Occupational Pensions Committee (EIOPC) regarding the impact assessment of the Solvency II level 1 Directive; and
- an issues schedule on the implementation and interpretation of the Financial Conglomerates Directive (2002/87/EC).

On 25 November, the Third Money Laundering Directive (Directive 2005/60/EC on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing) was published in the Official Journal (see our separate briefing). Member States must adopt national laws to comply with the Directive by 15 December 2007.

Also on 25 November, Council Regulation 1889/2005 on controls of cash entering or leaving the Community was published in the Official Journal. It applies from 15 June 2007. In essence, it requires any person entering or leaving the Community to declare to customs or

other authorities "cash" (currency or bearer or other instruments where the payee is not clearly identifiable) being carried of €10,000 or more.

On the same date, Directive 2005/56/EC on cross border mergers of limited liability companies was published. It must be implemented by 15 December 2007 (see July Briefing for short details).

Finally, the Commission published, on 15 December, its evaluation of the Settlement Finality Directive (98/26/EC), which implemented a payment infrastructure within the EEA to reduce systemic risk. The Commission's conclusions are that the Directive works well, though certain clarifications and improvements are desirable; the Commission will start a dialogue in 2006 to determine whether amendments to the Directive are needed.

**Timeline:** *The above documents and initiatives are subject to various timeframes. Full details are available on request.*

## 11. European Court of Justice

### 11.1 Preliminary Ruling References

**Case C-305-05** (money laundering - right to fair trial - human rights)

Referring Court: *Cour d'arbitrage* (Belgium)

Parties: *Ordre des barreaux francophones et germanophones, Ordre français des avocats du barreau de Bruxelles, Ordre des barreaux flamands, Ordres néerlandais des avocats du barreau de Bruxelles, Conseil des ministres*

The question referred to the European Court of Justice relates to Article 1(2) of Directive 2001/97/EC on the prevention of the use of the financial system for the purpose of money laundering. Article 1(2) inserts a new Article 2a(5) into Directive 91/308/EEC which includes members of the independent legal profession, including *avocats/advocaten* in Belgium, in the list of persons or establishments obliged to inform the authorities responsible for the fight against money laundering of any fact which might be an indication of such laundering.

The Belgian court's question is whether this provision infringes the right to a fair trial guaranteed by Article 6 of the Convention for the Protection of Human Rights and Fundamental Freedoms and Article 6(2) of the EU Treaty.

**Timeline:** *The reference was published in the Official Journal on 1 October.*

### 11.2 Judgements

**Case C-329/03** (free movement of capital - acquisition of bonds dealt in on a stock exchange - repatriation of proceeds of liquidation)

On 27 October, the Court delivered its judgement in *Trapeza tis Ellados AE v. Banque Artesia*.

The case was a preliminary ruling referred to the Court of Justice by order of the *Areios Pagos* (Greece). The case related to Artesia's application for compensation for damage suffered as a result of the Bank of Greece's refusal to authorise an account in convertible Greek drachma to be credited with the proceeds of the liquidation of bonds.

The European Court of Justice ruled, firstly, that bonds:

- denominated in national currency for a term of a one year from their issue;
- dealt in and quoted on a stock exchange;
- issued by a bank established in a Member State; and
- belonging to that State,

fall within List B, Item IV A of Annex I of the First Council Directive of 11 May 1960 for the implementation of Article 67 of the Treaty. This means that Member States must grant all authorisations required for the conclusion or performance of transactions or for transfers between residents of Member States that relate to such bonds in order to enable freedom of movement of capital and the liberalisation of capital movements.

Secondly, the acquisition, and proceeds of the liquidation, of bonds are governed by Article 2 of that Directive which refers, as regards the repatriation of those proceeds, to List B of Annex I. Member States are, therefore, again obliged to grant general permission in order to enable the conclusion or performance of transactions and transfers between residents of Member States relating to them.

Thirdly, the fact that an acquisition of bonds falling within List B, Item IV A of Annex I to the First Directive was financed using balances on current or deposit account with a credit

institution, even if falling within List D, Item IX of that annex, cannot have an influence on the classification of the capital movement in question under List B, Item IV A of that annex.

**Timeline:** *The Greek court will now apply the Court's judgement to the proceedings before it.*

**Case C-446/03** (corporation tax - groups of companies - deduction of losses - freedom of establishment)

On 13 December, the Court delivered its judgement in the case *Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes)*.

The case was a reference to the Court for a preliminary ruling by the High Court of Justice of England and Wales, Chancery Division (United Kingdom).

Marks & Spencer, a UK retailer, had claimed group relief from the UK tax authorities for losses incurred by UK subsidiaries and subsidiaries in a number of other Member States. However, under domestic legislation, the group companies could only set off their profits and losses among the subsidiaries established and trading in the UK. Marks & Spencer brought proceedings claiming that the provisions are incompatible with Articles 43 and 48 of the EC Treaty, the freedom of establishment provisions.

The Court ruled that:

- the UK rule constitutes a restriction on the freedom of establishment because it discourages companies from establishing subsidiaries in other Member States;
- such a restriction may only be permissible where it pursues a "legitimate objective justified by overriding reasons in the public interest". The UK's justifications for adopting the rule, i.e.
  - to ensure a balanced allocation of the power to impose taxes between Member States,
  - to avoid use of losses in more than one Member State, and
  - to ensure that companies do not avoid tax by declaring losses in Member States which apply the highest rates of tax where the value of losses is highest;

are legitimate objectives and constitute overriding reasons in the public interest;

- however, the UK rules go further than is necessary to attain the objectives and are, therefore, contrary to Articles 43 and 48, where:
  - the foreign subsidiary has exhausted the possibilities of using the losses in its State of residence for the accounting period concerned; and
  - there is no possibility for the foreign subsidiary or a third party to use the losses in its State of residence in the future.

Where the parent company can show that those conditions are met, the Member State in question must allow the parent company to deduct from its taxable profits the losses incurred by its foreign subsidiary.

Accordingly, the Court held that Articles 43 and 48 do not preclude Member State provisions which generally prevent a resident company from deducting, from taxable profits, losses in another Member State of a subsidiary established in that State, even though losses by a resident subsidiary could be deducted.

However, it is contrary to Articles 43 and 48 for a Member State to prevent a resident company from deducting from taxable profits losses incurred by a subsidiary established in another Member State, where the non-resident subsidiary has exhausted the possibilities available for claiming loss relief in the relevant or previous accounting periods in its State of residence, and where those losses cannot be taken into account in the subsidiary's State of residence in future accounting periods, either by the subsidiary itself or a third party, in particular where the subsidiary is sold to that third party.

**Timeline:** *The English court will now apply the Court of Justice's judgement to the proceedings before it.*

### 11.3 Opinions

**Case C-169/04** (Value Added Tax - exemption of the management of special investment funds - management)

On 8 September, Advocate General Kokott delivered her opinion in the reference for a preliminary ruling from the VAT and Duties Tribunal (UK) in the case of *Abbey National plc and Inscape Investment Fund v. Commissioners of Customs and Excise*.

Abbey National forms together with a number of its subsidiaries, including Inscape Investments Ltd, a group for the purposes of charging VAT. Certain of these companies are UCITS managers.

The trustees (depositories) of those UCITS charge a general trustee fee, plus VAT. That fee does not include any charges for acting as custodian. Abbey National contests the charging of VAT on the trustee fee, since it regards the trustee's activity as an exempt supply within the meaning of Article 13B(d)(6) of the Sixth VAT Directive (77/388/EEC).

Inscape Investment Fund, an open-ended investment company whose authorised corporate director is Inscape Investments Ltd, also objects to VAT being charged on the services of its depository.

Inscape Investments Ltd contracted out certain managing company functions, e.g. fund accounting, setting up and valuation of sub-funds, reconciliation and administration of accounts and payments out of the fund, and estimation of the administrative costs which are passed on to incoming or outgoing shareholders in the form of the dilution levy. The contractor charged VAT on those services. This too was challenged.

Following the questions referred to the European Court, the Advocate General considered that:

- the concept of 'management' within the meaning of Article 13B(d)(6) of the Sixth VAT Directive is an autonomous concept of Community law from which Member States may not diverge;
- services provided by a depository within the meaning of Articles 7 and 14 of the UCITS Directive 85/611/EC are exempt from VAT under Article 13B(d)(6) of the Sixth VAT

Directive if:

- they form a distinct whole and are essential for and specific to the management of the common fund or investment company, and
- the focus of those services is not on activities of safekeeping and administration within the meaning of Article 13B(d)(5) of the Sixth VAT Directive;
- services provided by an external manager in the form of administrative operation in the management of the fund are exempt from VAT under Article 13B(d)(6) of the Sixth VAT Directive, if they form a distinct whole and are essential for and specific to the management of the common fund or investment company.

**Timeline:** *No date has yet been set for the Court's judgement.*

## 12. Calendar of Events

### 21 December 2005

European Commission meeting (Brussels)

### 1 January 2006

Austria assumes Presidency of Council of Ministers

### 11 January 2006

European Commission meeting (Brussels)

### 16-19 January 2006

European Parliament plenary session (Strasbourg)

### 17 January 2006

European Commission meeting (Strasbourg)

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