

EU Financial Services BRIEFING



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1. VAT Treatment of Financial Services: Consultation

On 14 March, the Commission launched an online consultation on options for reforming current legislation on the VAT treatment of Financial Services - the Sixth VAT Directive (Directive 77/388/EEC).

The consultation is based on the Commission's 'Consultation Paper on modernising Value Added Tax obligations for financial services and insurance'.

Timeline: *The financial services industry, consumers and other interested parties have until 9 June to submit their comments on the Consultation Paper.*

2. Mergers and Acquisitions in the Financial Sector: Consultation on the Supervisory Approval Process

On 16 March, the Commission launched a consultation on how to improve the supervisory approval process for mergers and acquisitions in the banking, insurance and securities sectors.

One of the key difficulties is that the current legislation does not define how the prudential 'qualifications' of the proposed acquirer should be assessed. The absence of a definition consequently leads to a broad range of different interpretations by the supervisory authorities.

Timeline: *The Commission will issue a report this summer. Thereafter, if appropriate, the Commission will propose amendments to existing EU legislation.*

3. Services Directive: Commission adopts amended Proposal

On 4 April, the Commission adopted an amended proposal for a Directive on services following the European Parliament's vote at first reading in February.

The amended proposal states that providers of services enjoy access to EU markets in order to carry on their service activity throughout the EU. However, Member States may apply restrictive measures for reasons of protection of public policy, security, health and protection of the environment, provided such measures are non-discriminatory, necessary and proportionate to the objective sought.

Timeline: *The amended text will now be submitted to the EU Council of Ministers. If, as expected, the Council endorses the current text without any major changes, the Parliament could complete its second reading in the autumn with final adoption towards the end of the year.*

4. Sector Inquiry on the Payment Cards Industry

On 12 April, the Commission published a preliminary report on its sector inquiry into competition in the payment cards industry.

The report reveals several potential barriers to entry into payment card markets such as:

- structural barriers (e.g. vertical integration of many national payment card systems can impede new entrants at different levels of a payment card system's value chain);
- technical barriers (e.g. divergent technical standards across the EU prevent many services providers from operating efficiently on a European scale); and
- behavioural barriers (e.g. some payment systems exclude non-banks from the sector).

The Commission contends that business and consumers would benefit from a more integrated and competitive payment card industry. Making all forms of cross-border payments (including payment cards) as affordable as domestic payments could save the EU economy between €50 and €100 billion per year.

Timeline: *Industry, consumers and other interested parties have until 21 June to submit their comments on these preliminary findings. A*

final report will be published by the end of 2006. Furthermore, the Commission will issue interim reports on its inquiries into core retail banking and business insurance this autumn; the final reports will also be published by the end of 2006.

5. Commission investigates future Policy in the Internal Market

On 20 April, the Commission launched a public consultation on future policy in the internal market.

The consultation focuses in particular on the following five areas:

- fostering market dynamism and innovation – how to ensure an innovation-friendly market which business can access quickly;
- better regulation – how to ensure a high quality legislative and regulatory framework;
- better implementation and enforcement – how to make the most of the framework already in place;
- taking better account of the global context – how to ensure a better fit between the internal and external environments; and
- investing more in information and communication.

This consultation encompasses the entire single market programme, including financial services, and so is a useful adjunct to the Commission's White Paper on Financial Services, 2005 - 2010.

Timeline: *The consultation period runs until 15 June.*

6. Infringement Proceedings

6.1 Insurance Mediation Directive

On 19 April, the Commission announced its decision to refer Germany, Greece, France, Malta, Spain and Portugal to the European Court of Justice for failure to implement Insurance Mediation Directive (Directive 2002/92/EC) into their national laws. The Directive requires all intermediaries to be registered in their home Member State. Once registered, they are free to provide their services throughout the EU. The current incomplete implementation distorts the market.

The transposition deadline expired on 15 January 2005.

6.2 Supplementary Supervision of Financial Conglomerates Directive

On 19 April, the Commission announced its decision to refer Latvia and the Netherlands to the European Court of Justice for failure to communicate measures implementing the Directive on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate (Directive 2002/87/EC) into their national laws. This Directive lays down specific measures for the prudential supervision of financial conglomerates.

The transposition deadline expired on 11 August 2004.

6.3 IORP Directive

On 19 April, the Commission announced its decision to send reasoned opinions to Belgium, Cyprus, the Czech Republic, Finland, France, Italy, Lithuania, Slovakia, Slovenia, Spain and the United Kingdom for failure to implement, or to implement fully, the Directive on the activities and supervision of institutions for occupational retirement provision (IORP Directive, Directive 2003/41/EC) into their national laws. It provides for harmonized rules for prudential supervision and capital requirements for these institutions and for cross-border provision of occupational pensions.

The transposition deadline expired on 23 September 2005.

Timeline: Proceedings before the Court for failure to implement a Directive typically take 18 to 24 months. During this period Member States frequently implement the text in question and the proceedings are accordingly withdrawn.

7. Developments in Lamfalussy Committees

On 22 March, the Inter-Institutional Monitoring Group (IIMG) published its first interim report on the 'Lamfalussy process'. The IIMG, composed of six independent experts appointed by the European Parliament, Council and Commission, is responsible for assessing progress in implementation of the Lamfalussy process and for identifying and forestalling difficulties.

This first interim report does not provide a general assessment of the Lamfalussy process. It is limited to preliminary reflections and observations, focuses on specific, outstanding issues and reflects questions raised during the consultation phase. One of these is the concern that the Level 3 Committees, composed of national authorities, tend to protect national interests or practices. The work of the Committees therefore runs the risk of being more driven by 'consensus' than 'best practice'.

Timeline: The second interim report is scheduled for early 2007. The IIMG will conduct specific consultations which will give interested parties the opportunity to comment on this report.

Other developments:

CESR

- On 5 May, CESR published its second consultation paper on its draft guidelines regarding the cross-border notification procedure for UCITS funds. A public hearing will be held in Paris (before the end of May) at CESR's premises and information regarding the date and agenda will be made available on CESR's website shortly. As a consequence of CESR Members implementing the guidelines to simplify the notification procedure for UCITS passporting, it may be necessary for some Member States to amend national laws and regulations. Where such a procedure is necessary, a transitional period may be required for the implementation of the guidelines.

Timeline: CESR requests comments and reactions to its revised proposals by 1 June 2006, from both market participants and retail investors. It will finalise its guidelines by July 2006.

CEBS

- On 23 March, in response to a Commission request, CEBS published a questionnaire on current industry practices and thinking in relation to the measurement and management of concentration risk. CEBS' questionnaire covers the full range of banking and trading activities. In parallel with this questionnaire CEBS is consulting market participants on its guidance to supervisors and institutions on the management of concentration risk.

Timeline: The consultation period runs until 18 May.

- On 23 March, CEBS also launched a public consultation on additional technical guidance on application of the supervisory review process under the Capital Requirements Directive. The consultation paper complements CEBS guidelines on the supervisory review process issued in January 2006. The cornerstone of the process will be a structured dialogue between institutions and supervisors when reviewing and evaluating the institution's risk profile and capital needs.

Timeline: The consultation period runs until 23 June.

- On 4 April, CEBS published its guidelines on the implementation, validation and assessment of the risk management and risk measurement systems used by credit institutions and investment firms. These reflect a move to an advanced approach for calculating capital requirements. CEBS' guidelines reflect a common understanding of what supervisors should take into account when assessing an application from an institution to use the internal ratings based or advanced measurement approaches for regulatory purposes.
- On 6 April, CEBS started a second round of public consultation on the standards for outsourcing of credit institutions' business activities. The aim is to promote convergence in supervisory approaches to outsourcing. CEBS and CESR will ensure that the proposed standards are consistent with the regulatory framework defined by the Markets in Financial Instruments Directive (MiFID) as applied to credit institutions.

Timeline: The consultation period runs until 6 July.

CEIOPS

- On 10 February, CEIOPS and the Swiss Insurance Supervisory Authority (FOPI) signed a Memorandum of Understanding (MoU). The MoU aims to facilitate cooperation and exchange of information between the relevant EU supervisors and FOPI. It provides the legal basis for including FOPI in the work of the Coordination Committees that have been established under the 'Helsinki Protocol' (Protocol of 11 May 2000 relating to the Collaboration of EU

Supervisory Authorities with regard to the Application of Directive 98/78/EC on the Supplementary Supervision of Insurance Undertakings).

- On 26 April, CEIOPS adopted a Protocol, known as the 'Luxembourg Protocol', on the Insurance Mediation Directive. The Protocol lays down detailed provisions for cooperation and communication between supervisory authorities in order to ensure an efficient supervision of intermediaries and their cross-border activities in the EU.
- On 4 May, CEIOPS launched a second Quantitative Impact Study which will study the effect on insurance undertakings of the possible restatement of the value of both assets and liabilities under the Solvency II framework, as well as certain options for setting the capital requirement. The Commission has requested results by October 2006 in order to prepare the Solvency II Directive, and in particular the impact assessment for the future Directive.

Timeline: CEIOPS invites life and non-life insurance undertakings and reinsurers to participate in this exercise by completing and returning the spreadsheet and questionnaire to national supervisors by 31 July 2006.

8. Other recent Developments

On 5 May, the ECOFIN Council adopted conclusions on the Commission's White Paper on Financial Services Policy, 2005-2010. The Council laid particular emphasis on:

- clearing and settlement of securities transactions as a key area for financial integration;
- an effective Single Euro Payments Area;
- how to improve both the efficiency of pan-European markets for long-term savings products and consumer education and awareness;
- the importance of regulatory dialogue with third countries and of further opening of global markets;
- supervisory convergence and how to optimise cooperation between home and host State supervisors; and

- how to ensure that the regulatory approach of the Lamfalussy process will meet the challenge of accelerating integration financial markets.

9. European Court of Justice

9.1 Judgements

Case C-253/03 (Freedom of establishment – Tax legislation – Tax on company profits)

On 23 February, the Court delivered its judgment in the reference for a preliminary ruling in *CLT-UFA SA v. Finanzamt Köln West*.

The German Federal Tax Court referred the case to the European Court of Justice to determine whether the tax treatment of a permanent establishment (PE) constituted prohibited discrimination and, if so, whether the correct tax rate to be applied to the PE's 1994 profits should be 30 percent or 33.5 percent, taking into account the 5 percent dividend withholding tax on the cash dividend.

The Court held:

- the definitive tax rate of 42 percent levied at that time on profits of a PE compares unfavourably with a definitive tax burden of 30 percent or 33.5 percent in the case of a subsidiary. This detrimental tax treatment cannot be justified, because there is no fundamental difference between a PE and a subsidiary. The Court therefore concluded that German PEs were, at the time, subject to unjustified tax rate discrimination; and
- it is necessary to apply a tax rate to the PE's profits that is equivalent to the overall tax rate that would have applied in the same circumstances to distribution by a subsidiary of profits to its parent. The Court did not specify the applicable tax rate because it is a factual issue to be decided by the national court.

Timeline: *The case will be referred back to the German Court which will apply the Court's judgement.*

Case C-169/04 (Sixth VAT Directive – Article 13B(d)(6) – Management of special investment funds – Exemption – Meaning of 'management' – Functions of a depositary – Delegation of administrative management function)

On 4 May, the Court delivered its judgement in *Abbey National plc & Inscape Investment Fund v. Commissioners of Customs & 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 (depositaries) of those UCITS charge a general trustee fee, plus VAT. That fee does not include any charges for acting as custodian/depositary. Abbey National contested the charging of VAT on the trustee fee, since it regarded 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 objected to VAT being charged on the services of its depositary.

In sum, the Court ruled that:

- the concept of 'management' of special investment funds in Article 13B(d)(6) of the Sixth VAT Directive has its own independent meaning in Community law, the content of which the Member States may not alter. This means that a Member State tax authority cannot adopt an excessively restrictive interpretation of the exemption;
- the management services would benefit from the VAT exemption under Article 13B(d)(6), whereas the depositary services could not.

Timeline: *The case will be referred back to the VAT and Duties Tribunal, London, which will apply the Court's judgement.*

9.2 Opinions

Cases C-452/04 (Free movement of capital – Freedom to provide services – Grant of credit by an undertaking having its registered office in a third country to residents of a Member State – Requirement of prior authorisation in the Member State in which the service is provided – Abuse)

On 16 March, Advocate General Stix-Hackl delivered her opinion in the reference for a preliminary ruling in the case of *Fidium Finanz AG v. Bundesanstalt für Finanzdienstleistungen (BAFin)*.

A German court referred this case to the European Court of Justice. The referring court asked whether, in the context of consumer credit activities, an undertaking, having its registered office in a third country, could rely on EC principles of free movement of capital and freedom to provide services. The referring court also asked whether a Member State would be justified in imposing a requirement for authorisation and whether such authorisation could be subject to the condition that the undertaking has its central administration or at least a branch in the Member State concerned.

The Advocate General's conclusions may be summarised as follows:

- under the Treaty, the free movement of capital takes precedence over the freedom to provide services;
- free movement of capital is applicable even for a third country;
- however, a Member State can justifiably subject the activities of an undertaking from a third country to an authorisation requirement; and
- that authorisation requirement can include a requirement for the third country undertaking to set up a branch in the Member State in question.

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

10. Calendar of Events

24 May 2006

European Commission meeting (Brussels)

30 May 2006

EP Economic & Monetary Affairs Committee meeting

31 May 2006

European Commission meeting (Brussels)

31 May-1 June 2006

European Parliament plenary session (Brussels)

1-2 June 2006

Committee of European Banking Supervisors (CEBS) meeting (Vienna)

6 June 2006

Eurogroup meeting

7 June 2006

Ecofin Council meeting and European Commission meeting

11-12 June 2006

EP Economic & Monetary Affairs Committee meeting

12-15 June 2006

European Parliament plenary session (Strasbourg)

13 June 2006

European Commission meeting (Strasbourg)

15-16 June 2006

European Council meeting

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