

EU Financial Services BRIEFING



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1. ECOFIN Luxembourg Presidency Work Programme

On 5 January, the Luxembourg Presidency set out the ECOFIN work programme. As regards financial services, the Presidency intends to continue the effort to complete the internal market by means of improved implementation of Directives. It intends to achieve political agreement with the European Parliament at the first reading stage on the:

- Directive on Capital Adequacy Requirements;
- Directive on Statutory Audit of Annual and Consolidated Accounts; and
- Reinsurance Directive.

The Presidency also intends to take forward discussions on amendments to the Accounting Directives with a view to adopting political guidelines.

In relation to money laundering, the Presidency will seek political agreement on the proposed third Money Laundering Directive.

Timeline: The Luxembourg presidency will continue until the end of June 2005.

2. ECOFIN extends Lamfalussy Process to Banking and Insurance

At its meeting of 18 January, the ECOFIN Council agreed with the Commission and the Parliament to extend the mandate of the Inter-institutional Monitoring Group to banking, insurance and occupational pensions.

The Group is responsible for assessing progress in the implementation of the Lamfalussy process to secure a more effective regulatory system for financial services.

Timeline: The Inter-institutional Monitoring Group will function until at least 31 December 2007.

3. CESR publishes Guidelines for Supervisors on UCITS

On 3 February, the Committee of European Securities Regulators (CESR) published guidelines for applying the transitional provisions in the amending UCITS Directives (2001/107/EC and 2001/108/EC). The purpose is to end the uncertainty faced by market participants and achieve convergence of the different administrative practices applied in various Member States. In particular, the guidelines deal with:

- marketing of funds and the simplified prospectus;
- permissible activities of "grandfathered" management companies;
- UCITS launched after February 2002 which benefit from a "grace period";
- treatment of grandfathered UCITS I umbrella funds which have launched other sub-funds since February 2002;
- the European passport; and
- the relationship between the management company's passport and the fund's passport.

The Guidelines are not legally binding, but CESR members are expected to put them into practice on a voluntary basis.

Timeline: CESR will review compliance with its guidelines in the second half of 2005.

4. CESR consults on MiFID Level 2 technical Implementing Measures

On 3 February, CESR published a second consultation paper on Level 2 technical measures to implement the Markets in Financial Instruments Directive (2004/39/EC), in part to address certain comments on the structure and other aspects of the first consultation paper.

The paper addresses best execution and market transparency; it concentrates on the admission of financial instruments to trading on regulated markets; and, in particular, it discusses the:

- requirements for financial instruments to be traded on regulated markets:
 - generally, transferable securities must be freely negotiable, subject to certain limited exceptions;
 - requirements are also proposed for information on money market instruments with an initial maturity of less than 12 months, units in collective investment schemes and derivatives;
- duty of regulated markets to verify the compliance of issuers with prospectus and disclosure requirements, and facilitate the flow of information to members and participants.

Timeline: Contributions to the consultation are required by 3 March 2005.

5. CESR publishes Paper on third Country GAAP Equivalence

On 3 February, CESR published a final concept paper setting out its approach to the analysis of equivalence of certain third country GAAP (Canadian, Japanese and US) and international accounting standards/international financial reporting standards (IAS/IFRS). The analysis is necessary for the purposes of the Regulation on Prospectuses and the Transparency Obligations Directive, which require financial statements to be prepared on a basis equivalent to IAS/IFRS.

According to the paper, equivalence would not require identical GAAP. Third country GAAP could be equivalent, subject to remedies such as additional disclosure or reconciliation.

The paper forms the first step in developing CESR's final advice to the European Commission, following a mandate in October 2004. The next step is the preparation of the technical advice that would assist in reaching the final assessment on whether a given third country GAAP is equivalent to IAS/IFRS.

Timeline: CESR must deliver its advice by 30 June 2005.

6. Commission adopts Regulations on International Accounting Standards

On 29 December 2004, the Commission adopted various Regulations, including Regulations 2236/2004 and 2237/2004, amending Regulation 1725/2003 by which it adopted certain international accounting standards and interpretations.

Regulation 2236/2004 follows the publication by the International Accounting Standards Board (IASB) of three new IFRSs including IFRS 4 on insurance contracts. In order to ensure consistency, the Regulation also amends a number of other international accounting standards.

Regulation 2237/2004 results from the revision of IAS 32 on financial instruments: disclosure and presentation, by the IASB. IAS 32 establishes basic principles for the classification of instruments as liabilities or equity. The IASB's revision has not made any fundamental changes to the Standard.

Timeline: The new standards apply to the consolidated accounts of listed Community companies from 1 January 2005.

7. Commission issues Paper on current State of Play of the Collateral Directive

On 21 January, the Commission issued a note on implementation of the Collateral Directive (2002/47/EC) (due by 27 December 2003 for "old" Member States and by 1 May 2004 for "new" Member States). The objective of the Directive is to create a uniform EU legal framework to limit credit risk in financial transactions through the provision of securities and cash as collateral.

According to the Commission, only 16 Member States have so far implemented the Directive. Of the remaining nine, Greece, France and Luxembourg are facing infringement proceedings in the European Court of Justice for non implementation, under Article 226 EC Treaty.

The Commission will also be issuing a reasoned opinion against the Netherlands. Sweden and Belgium have also failed to implement the Directive, but have provided a detailed timetable for entry into force of national laws. Latvia, the Czech Republic and Slovakia announced that they will implement the Directive during spring 2005.

The Commission intends to report to the European Parliament and Council on the application of the Directive including its scope, the option not to allow for appropriation of collateral and the right of use of financial collateral provided under security financial collateral arrangements.

The report may include proposals for revision of the Directive; these may take into account parallel activities on clearing and settlement.

Timeline: The Commission's report will be presented by 27 December 2006 at the latest.

8. Commission commences Proceedings against Greece, France and Luxemburg

The Commission announced on 22 December 2004 its decision to refer Greece, France and Luxemburg to the European Court of Justice for failure to implement Directive 2001/65/EC relating to the valuation rules of the annual and consolidated accounts of certain companies including banks and other financial institutions.

The Directive requires the application of "fair value" in accounting for certain financial instruments including derivatives, providing for alignment with international valuation standards.

The Commission has also decided to send reasoned opinions (the second stage of infringement proceedings under Article 226 EC Treaty) to Germany and, in relation to Gibraltar, to the UK, requiring implementation of the Directive.

Timeline: *If the Commission does not receive a satisfactory response from Germany and the UK within two months, it may institute proceedings before the European Court of Justice.*

9. Commission commences Proceedings against Portugal for Infringement of Tax Legislation

The Commission announced on 13 January that it has decided to take action against Portugal in the European Court of Justice for discriminatory application of a capital gains tax relief.

Portugal's tax legislation provides for tax relief on capital gains from sales of certain residential property but only where the proceeds are reinvested in property on Portuguese territory. The Commission considers that this provision is contrary to the Treaty right of free movement of persons, and also to the freedom of establishment and the free movement of capital.

Timeline: *No date has yet been set for hearing the case.*

10. Commission commences Proceedings against Greece for Infringement of Tax Legislation

The Commission announced on 13 January its decision to send a reasoned opinion to Greece concerning certain capital duty provisions.

Greek legislation applies a capital duty to companies that transfer their registered seat or effective management to Greece, but provides an exemption from the duty for agricultural and maritime companies. The Commission considers that these rules infringe Directive 69/335/EEC relating to indirect taxation on the raising of capital.

In the Commission's view the Directive does not permit Greece to charge to capital duty the transfer of a registered office or effective place of management from another Member State or a third country. Also, whilst the Directive allows for some transactions to be exempted from duty, it does not permit the exemption of entire sectors. The Commission is also of the opinion that certain State aid considerations may apply.

Timeline: *If Greece does not amend its legislation within two months, the Commission may refer the matter to the European Court of Justice.*

11. Commission requires Abolition of Tax Benefits for Exempt Companies in Gibraltar

The UK has accepted a Commission Recommendation issued on 19 January calling upon it to phase out the tax benefits afforded to Exempt Companies in Gibraltar. This will bring to an end the last offshore tax regime in Gibraltar.

Under the regime, a company registered as exempt pays no income tax on its profits but is instead subject to a fixed annual tax of between £225 and £300. The scheme is considered to infringe State aid rules and, therefore, to distort competition.

Existing beneficiaries of the regime will have their benefits "grandfathered" until 31 December 2010 unless they change ownership/activity. The number of new entrants to the scheme will be gradually decreased and their benefits will be grandfathered only until 31 December 2007. No new entrants will be allowed after 30 June 2006.

Timeline: *The Recommendation recommends the regime should expire by the end of 2010.*

12. CESR publishes final Recommendations on Prospectus Regulation

On 10 February, CESR published its final recommendations for the consistent implementation of the Prospectus Regulation (see May 2004 issue). The recommendations, after extensive consultation with industry, form CESR's level 2 advice to the European Commission under the Lamfalussy process.

The main objective of these recommendations is to clarify the provisions on the requirement for information disclosure and to increase transparency in the application of the Regulation by supervisors. The recommendations covered by CESR include:

- disclosure requirements in relation to operating and financial review, profit forecast or estimates, pro forma financial information and working capital statements;
- measures to co-ordinate the application of Article 23 of the Regulation by competent authorities i.e. the requirement for adapted information by issuers such as start-ups or property companies;

- clarifying measures on related party transactions, history of share capital and information on holdings; and
- contents of documents relating to securities offered to employees or offers of shares allotted free of charge to existing shareholders.

Timeline: *The Prospectus Regulation will apply with effect from 1 July 2005.*

13. Council adopts Taxation on Mergers Directive

On 17 February, the ECOFIN Council adopted a Directive amending Directive 90/434/EEC on "the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States" (the "Mergers Directive"). The Mergers Directive provides for tax deferral in cases of cross-border mergers and divisions of companies. The new Directive facilitates cross-border mergers. In particular, it:

- expands its scope to: certain co-operatives and forms of partnership, mutual companies, savings banks, funds and associations with commercial activity, the European Company and the European Co-operative Society (available from 2006);
- provides that, under certain conditions, the transfer of the registered office of a European Company or of a European Co-operative Society from one Member State to another will not give rise to immediate taxation of unrealised gains on assets remaining in the first Member State;
- confirms that tax deferral is available to companies that convert a foreign branch into a subsidiary; and
- expands the Mergers Directive's application to "partial divisions" or "split-offs".

Timeline: *Member States must implement the provisions relating to the transfer of the registered office of a European Company or of a European Co-operative Society by 1 January 2006, at the latest. The rest of the provisions must be implemented by 1 January 2007.*

14. Commission Communication on Financial Services

On 2 February, Commission President Barroso submitted a Communication to the Spring European Council setting out amendments to the scope and focus of the Lisbon agenda. His intention was to outline a strategy for putting the Lisbon agenda "back on track".

The Communication focuses on two main tasks: delivering stronger, lasting growth; and creating more and better jobs.

On financial services, Mr Barroso states that key reforms are required in order to complete the single market. Although the Financial Services Action Plan (FSAP) was a successful element of the first phase of the Lisbon Strategy, it is still crucial to ensure that Community legislation is applied consistently across the EU.

In the meantime, the EU may also have to address some areas that have not been covered by the FSAP. However, action will only be taken if broad consultations and impact assessments demonstrate clear added value.

Mr Barroso added that competition policy is of fundamental importance and has played a key role in shaping European markets and increasing productivity. This contribution can be maintained through active enforcement and state aid reform. In particular, the President announced that the Commission intends a screening of the barriers to competition in the financial services sector.

Enforcement of competition policy in key sectors, such as financial services, will assist in identifying regulatory and other barriers to competition and help ascertain the underlying reasons why the market does not function fully.

Timeline: *The Competition Commissioner, Neelie Kroes, has also stated that screening will be a priority.*

15. European Court of Justice

15.1 Proceedings by Commission

Case C-501/04 (transfer of portfolio - life and non-life insurance)

On 6 December 2004, the Commission commenced an action in the European Court of Justice against the Kingdom of Spain.

The Commission claims that the European Court of Justice should declare that Spain has failed to fulfil its obligations under the Non-Life and Life Insurance Directives (92/49/EEC and 2002/83/EC respectively).

Under Spanish law, policyholders have the option of cancelling contracts in the event of transfer of an insurance portfolio where the transferor and/or transferee is not an insurance undertaking with its head office in Spain. The option to cancel is not available where the transfer is between Spanish undertakings.

The Commission argues that the Spanish legislation is discriminatory because it provides for less favourable treatment of insurance undertakings operating in Spain under the freedom of movement or right of establishment, compared with undertakings incorporated in Spain. It adds that the difference in treatment is not based on objective differences and is not justified by considerations relating to consumer protection.

Timeline: No timetable has been set for the hearing of the case.

15.2 Opinions

Case C-472/03 (insurance - mediation - exemption from VAT)

On 12 January, Advocate General Poiares Maduro delivered his opinion in the case of *Staatssecretaris van Financiën v. Arthur Andersen & Co. Accountants c.s.*

Arthur Andersen provided "back office" services to an insurer. It claimed repayment by the Dutch authorities of VAT; the repayment was refused. The question referred to the Court was whether the services provided to the insurer fell within the exemption in Article 13B(a) of the Sixth VAT Directive.

The Advocate General considered that:

- the activities of Arthur Andersen did not amount to insurance operations, so could not fall within the exemption on this count;
- Arthur Andersen's activities did not fall within the definition of insurance mediation in the intermediaries Directive 77/92/EEC (now replaced by Directive 2002/92/EC);

- insurance mediation requires an intermediary relationship with both the policyholder and the insurer. In the present circumstances it appeared that other intermediaries had such a relationship with policyholders;
- insurance mediation necessarily involved finding potential clients and putting them in touch with an insurer; and
- in the circumstances, the activities of Arthur Andersen amounted to subcontracted work of the insurer.

The activities of Arthur Andersen did not, therefore, include insurance mediation. The Advocate General concluded that the European Court should respond to the effect that the activities of the taxpayer would not fall within the exemption from VAT to the extent that the taxpayer is not in direct contact with both insurer and insured, and its activities are not independent of the insurer's activities.

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

Case C-77/04 (insurance - third party proceedings - application of Brussels Convention)

On 24 February, Advocate-General Jacobs delivered his opinion in *Groupement d'Intérêt Économique (GIE) Réunion Européenne and Others v. Zurich España*.

In this case Zurich was the insurer of the owner of vehicles stored in a car park in France and damaged by a storm. The owner had brought proceedings against the car park owner in respect of the damage, and the owner's insurers had paid the claim.

The owners sued its insurers (the claimants in this action) in France to recover the amount paid out. These insurers sought to join Zurich to the proceedings. The Montpellier Court of Appeal held that Zurich could not be joined to the French proceedings. The present case, following a reference for a preliminary ruling by the Court of Cassation, to which the insurers had appealed, concerns the application of the Brussels Convention on jurisdiction and the enforcement of judgments.

In essence, the issue was whether Article 6 (2) of the Convention would apply to determine jurisdiction, or Section 3 (which relates specifically to insurance).

In the Advocate-General's opinion, third party proceedings between insurers based on alleged multiple insurance are not covered by the Convention's provisions relating specifically to insurance. Those provisions are intended to protect a party in a weak economic position (such as an insured), not an insurer; in addition, the relationship between the insurers and Zurich was not one of co-insurance; finally, the provisions of Article 11 (part of Section 3) were not applicable to the circumstances of the case.

The Advocate-General was of the opinion that Article 6 (2) of the Convention would apply in determining jurisdiction in third party proceedings (as defined by national procedural rules) between insurers, provided there is no evidence that the original proceedings were brought solely with the intention of removing the defendant to the third party claim from the jurisdiction of the court which would be competent.

Timeline: No date has yet been set for the judgement of the European Court.

16. Court of First Instance

16.1 Judgements

Case T-93/02 (State aid - annulment of a Commission Decision)

On 18 January, the Court of First Instance delivered its judgement in the case *Confédération Nationale du Crédit Mutuel v. Commission*.

The case was an appeal by Crédit Mutuel against a Commission Decision of 15 January 2002 declaring a State aid implemented by the French Republic in favour of Crédit Mutuel to be incompatible with the Treaty.

Crédit Mutuel had been entrusted by the French authorities with the exclusive distribution of a tax-free savings product, the *Livret Bleu*. In its Decision, the Commission claimed that Crédit Mutuel was overcompensated for the costs of the product in breach of European State aid rules. The company was ordered to repay €164 million of the overcompensation received between 1991 and 1998.

The Court of First Instance upheld the appeal and annulled the Commission's decision on the grounds that it had not been sufficiently justified

according to criteria that require that the intervention should:

- emanate from the State or through State resources;
- be liable to affect trade between Member States;
- confer an advantage on the recipient of aid; and
- result in aid that distorts or threatens to distort competition.

There was no decision on whether there had been overcompensation or not.

Timeline: The Commission has two months to decide on an appeal to the European Court of Justice.

17. EFTA Court

17.1 Initiation of Proceedings

Case E-8/04 (banking - freedom of establishment)

On 8 November 2004, the EFTA Surveillance Authority brought an action against Liechtenstein concerning certain provisions of its banking legislation.

The Liechtenstein Banking Act requires of a bank established in the Principality that at least one member of the bank's management board and its executive management be resident in Liechtenstein.

The Surveillance Authority considers that this requirement is contrary to the right of freedom of establishment in Article 31 of the EEA Agreement.

Timeline: Liechtenstein had until 18 February 2005 to make a submission in response to the action.

Case E-9/04 (banking - State aid)

On 23 November 2004, the Bankers' and Securities Dealers' Association of Iceland brought an action against the EFTA Surveillance Authority.

The Surveillance Authority's decision (213/04/COL) of 11 August 2004 held that loans by the Icelandic Housing Financing Fund were compatible with State aid rules under Article 59(2), EEA. The applicant claims that the decision should be annulled on the basis that:

- the Authority violated its obligation to initiate formal proceedings;
- infringed essential procedural requirements by not providing adequate reasons; and
- wrongfully interpreted and applied Article 59(2) EEA.

Timeline: *The EFTA Surveillance Authority must have made a submission in response by 25 February 2005.*

18. Calendar of Events

2 March 2005

European Commission meeting (Brussels)

7 March 2005

Eurogroup meeting

7-10 March 2005

European Parliament plenary session (Strasbourg)

8 March 2005

Ecofin Council meeting

8 March 2005

European Commission meeting (Strasbourg)

14-15 March 2005

EP Committee on Economic and Monetary Affairs (with ECB President J-C Trichet)

16 March 2005

European Commission meeting (Brussels)

22-23 March 2005

European Council meeting (Brussels)

24-28 March 2005

EU institutions closed

27 March 2005

Easter Sunday

29-30 March 2005

EP Committee on Economic and Monetary Affairs

11-14 April 2005

European Parliament plenary session (Strasbourg)

11 April 2005

Eurogroup meeting

12 April 2005

Ecofin Council meeting

18-19 April 2005

EP Committee on Economic and Monetary Affairs

If you have any questions concerning this briefing, please contact Philip Woolfson on +32 2 626 05 19 (pwoolfson@steptoe.com) or Simon Arnot on +32 2 626 05 43 (sarnot@steptoe.com).

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STEPTOE & JOHNSON LLP

Box 5, 240 Avenue Louise
1050 Brussels
Tel: +32 (2) 626 05 00
Fax: +32 (2) 626 05 10

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