

EU Financial Services BRIEFING



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1. Commission issues Capital Requirements Consultation

On 8 April 2005, the European Commission issued a consultation on proposals relating to the future treatment of "trading activities related issues and the treatment of double default effects". Interested parties are invited to comment on a Working Document setting out proposed amendments to the Commission's Proposal for a Capital Requirements Directive of 14 July 2004 (COM (2004)486). The proposals cover:

- the treatment of counterparty credit risk for over-the-counter derivatives, repurchase agreements and securities financing transactions, and of cross product netting arrangements. The consultation paper covers four methods of calculating the exposure value of transactions, to enhance treatment in the light of the internal ratings based approach of the proposed Directive;
- the treatment of double default effects for covered transactions in relation to trading and banking book exposures. The Commission seeks to reflect best practice. The double default framework will not be available within the standardised approach;
- the short term maturity adjustment in the Basel II internal ratings based approach. This relates to cases where the nature of obligations is such as to extend the effective maturity date of the transaction;
- improvements to the current trading book regulatory regime in the light of an increase in availability of risk-related products and structured and exotic products; and
- the design of a specific capital treatment of unsettled and failed transactions.

Timeline: The deadline for responses to the Commission's consultation is 27 May 2005. The proposed Directive should be adopted in late

2005. Implementation in the Member States is due by 1 January 2007 for the simple and intermediate approaches, and by 1 January 2008 for advanced approaches.

2. Commission issues Markets in Financial Instruments Consultation

The European Commission has published a Working Document on the implementation of Articles 25 and 58 of Directive 2004/39/EC, the Markets in Financial Instruments Directive (MiFID). Article 25 requires competent authorities to monitor investment firms' activities to ensure the integrity of the market. Article 58 concerns exchange of information between the Member States' authorities. The document considers draft level 2 implementing legislation in relation to:

- transactional information in the reports sent by investment firms to competent authorities (Article 25.3 and 25.4);
- the methods of reporting transactions executed by investment firms to the competent authorities (Article 25.3);
- the relevant competent authorities for exchange of information in relation to transaction reports and relevant arrangements (Article 25.5); and
- exchange of other information between competent authorities pursuant to a request for information (Article 58).

The Commission proposes two options for transmission of information to other competent authorities; these cover direct exchange between authorities and exchange through a central database. CESR is assessing these costs.

The Commission has invited interested parties to comment on the Working Document.

Timeline: The deadline for responses to the Commission's consultation is 4 June 2005.

3. Council approves Cash Control Proposal

On 17 February 2005, the Economic and Financial Affairs Council ("ECOFIN") formally adopted its common position concerning the proposed Regulation of the Council and the Parliament on controls of cash entering or leaving the Community.

The purpose of the Regulation is to complement the existing money laundering regulatory framework, under Directive 91/308/EEC (as amended), which applies to money transfers via financial and credit institutions and certain professions only. It introduces harmonised rules requiring natural persons entering or leaving the European Union to declare to customs authorities cash movements above a certain amount.

Among other matters, the common position amended the draft to:

- add Article 95 of the Treaty (harmonisation of internal market provisions) to the legal base;
- introduce a mandatory declaration requirement in either written, electronic or oral form;
- lower the threshold for making a declaration from €15,000 to €10,000; and
- indicate that national intra-community cash controls may be maintained.

Timeline: The European Parliament is expected to vote on the Proposal in its second reading in June 2005.

4. Council confirms Entry into Force for Savings Tax Legislation

On 12 April 2005, ECOFIN examined the state of the ratification of agreements concluded with Andorra, Liechtenstein, Monaco, San Marino, Switzerland and ten dependent and associated territories of the UK and the Netherlands in relation to taxation of savings. The Council also examined the implementation of Directive 2003/48/EC on taxation of savings in the Member States.

The Council welcomed the progress made in the application in the above territories of these measures, which should be in place as from 1 July 2005. In addition, it adopted the following conclusions:

- that the Directive will apply to all interest payments made from 1 July 2005, excluding any interest accrued before that date;
- only income from undertakings for collective investment in transferable securities (UCITS) which invest less than 15% of their assets in debt claims may be excluded from the

definition of interest payments set out in Article 6(1) of the Directive; and

- the Member States and the Commission, and the Netherlands and the UK respectively for third parties and dependent territories, will guarantee that they will act in full conformity with the requirements described in the preceding paragraph.

Timeline: The Council will review the situation at its meeting of 7 June 2005.

5. Commission on-line Survey on cross-border Mergers

On 18 April 2005, the European Commission launched a survey on the underlying factors preventing cross-border consolidation in the financial sector. The Commission will use the responses as a basis for a report to the September ECOFIN Council.

The report will be the Commission's response to the Council's request to study possible obstacles to cross-border mergers (see October 2004 Briefing). The Commission will consider the following when compiling its report:

- the outcome of the consultation;
- the economic facts published in the 2005 Financial Integration Monitor report;
- the results of a review of the application of Directive 2000/12/EC (the Credit Institutions Directive) that allows Member States to block mergers on prudential grounds; and
- the results of a review of the application of the Treaty based freedom of capital movements to cross-border mergers in the financial sector.

In addition, on 4 April 2005, the Committee of Banking Supervisors (CEBS) issued a questionnaire to solicit the views of the banking industry on the effect of the criteria used by national supervisory authorities in deciding when to oppose the acquisition of a qualifying holding on the grounds that the acquisition could threaten the "sound and prudent management" of the target institution. The replies will be used to formulate CEBS' technical advice to the Commission regarding Article 16 of Directive 2000/12/EC.

Timeline: The survey will be open until 15 June 2005. The results will be available at the Commission web site before the end of July 2005. The replies to CEBS' questionnaire must be sent by 30 April 2005.

6. Commission accepts European Aviation Insurers' Commitments to promote Competition

On 23 March 2005, the European Commission announced that it had accepted commitments by leading European aviation insurers to reform their practices in order to promote competition and transparency in the sector. The undertakings were given by the International Underwriting Association of London and the Lloyd's Market Association and bind their members. They include a commitment to:

- introducing consumer input to standard clauses devised by industry committees for aviation insurance policies; and
- limiting co-ordinated action in situations of crisis - e.g. resulting from war or terrorism - to that which is indispensable to ensure continued availability of capacity and insurance cover; the effects on competition from such action must be kept to a strict minimum.

The latter commitment will see the replacement of the Joint Executive Committee by a new Aviation Liaison Forum.

The undertakings follow an investigation by the Commission on whether the industry's practices in the aftermath of 11 September 2001 breached European competition rules. The Commission will not pursue its investigation any further as the undertakings offered have adequately addressed its concerns. However, it has announced that it will "...continue to monitor market developments and keep the aviation insurance market under close scrutiny."

7. Commission takes Action against the UK for Failure to implement Winding-up Directive

On 22 March 2005, the European Commission announced that it had decided to send a letter of formal notice to the UK requiring information about the measures taken to implement into national law Directive 2001/17/EC on the reorganisation and winding-up of insurance

undertakings. The European Court of Justice has already ruled on the subject in case C-164/04 of 18 November 2004, and required the UK to implement the Directive into national law.

The UK government has adopted legislation to ensure implementation in Gibraltar and has initiated legislation as regards the Lloyd's market. However, until all relevant legislation has been adopted, the Commission considers that the Directive has not been fully implemented.

Timeline: *The Commission may decide to initiate infringement proceedings in the form of a reasoned opinion and, thereafter, to bring the infringement before the European Court.*

8. Commission requires Abolition of French Tax Exemptions for Mutual and Provident Societies

On 2 March 2005, the European Commission announced the adoption of a Recommendation calling on France to abolish, by 1 January 2006, a tax exemption enjoyed by mutual and provident societies governed by the Code on Mutual Societies. The exemption concerns these societies' non-health insurance contracts which are currently exempt from tax on insurance contracts.

The Commission considers that the exemption constitutes unlawful state aid as it confers an unfair advantage on mutual and provident societies to the detriment of other French or foreign undertakings offering similar products in France.

However, as the exemption was in place before the entry into force of the Treaty of Rome, it falls into the category of "existing aid" which may only be removed with the co-operation of the French authorities.

If France refuses to address the Commission's concerns, the Commission may open a formal investigation procedure. It should be noted that "existing aid" is not paid back.

Timeline: *France has one month to respond to the Commission's recommendation.*

9. EU and US agree on Accounting Standards Approach

On 22 April 2005, the European Commission announced an agreement with the US Securities and Exchange Commission (SEC) regarding EU

and US accounting standards. The agreed approach will set out steps to establish equivalence between the International Financial Reporting Standards (IFRS), the European accounting standards, and the US Generally Accepted Accounting Principles (US GAAP).

The objective of the agreement is to eliminate the need for European companies using IFRS to reconcile to US GAAP and, thus, reduce the associated regulatory burden and costs.

Timeline: *The aim is to reach equivalence by 2007 and, in any case, no later than 2009. The Internal Market Commissioner and the Chairman of the SEC will be meeting again next year in order to review the progress of the project.*

10. European Court of Justice

10.1 Judgements

Case C-219/03 (tax on capital gains - Spain)

On 9 December 2004, the European Court of Justice handed down its judgement in the case of *Commission v. Kingdom of Spain*.

The Spanish tax regime provides for a higher deduction for the purposes of capital gains tax on transfers since January 1997 of certain shares purchased before 31 December 1994 and quoted on Spanish regulated markets, as opposed to those quoted on other markets. The Commission considers this an obstacle to the free movement of capital and the freedom to provide services, as it deters persons liable to Spanish income tax from investing in shares quoted on markets other than Spanish markets.

The Court found for the Commission and declared that: "... with regard to the tax on capital gains made since 1 January 1997 on transfers of shares purchased prior to 31 December 1994, by maintaining in force a tax regime which is less favourable to shares quoted on markets other than Spanish regulated markets than to shares quoted on the latter markets, the Kingdom of Spain has failed to fulfil its obligations under Articles 49 EC and 56 EC and the corresponding Articles 36 and 40 of the agreement on the European Economic Area."

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

On 3 March, the European Court of Justice handed down its judgement in the case of

Staatssecretaris van Financiën v. Arthur Andersen & Co. Accountants c.s.

Arthur Andersen (AA) 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 Court (following the opinion issued earlier this year by the Advocate General; see February 2005 Briefing) interpreted the category of services exempt under Article 13B(a) restrictively.

The Court first concluded that AA's activities did not amount to 'insurance transactions' as there was no contractual relationship between AA and the insured parties within the meaning of Article 13B(a) of the Sixth Directive. Consequently, the Court ruled solely on the concept of 'services related to insurance transactions performed by insurance brokers and insurance agents' in the following terms:

- the exemptions contained in Article 13 of the Sixth VAT Directive must be construed narrowly;
- AA does not fall within the definition of insurance broker because it does not have complete freedom to choose the insurer;
- AA's activities do not fall within the definition of insurance agent. The existence of power to render the insurer liable, the presence of life assurance expertise and activities related to insurance transactions are not sufficient;
- AA's activities are not typical of those of an insurance agent as they include aspects not performed by such agents and do not include essential aspects of the work of an insurance agent i.e. the introduction of prospects to the insurer; and
- AA's activities amount to sub-contracted work of the insurer consisting of the performance of activities that would usually be performed by the insurer but not by an insurance agent.

In conclusion, the Court ruled that Article 13B(a) of the Sixth Directive must be interpreted to mean that the provision of 'back office' services to an insurance company does not constitute the performance of services relating to insurance transactions carried out by an insurance broker

or an insurance agent within the meaning of that provision.

Timeline: *The Dutch referring court (and national tax authorities) will now apply the ruling to this and other back office and similar cases. N.B. a full briefing memorandum is available from our firm.*

10.2 Proceedings by Commission

Cases C-497/04 and C-498/04 (implementation of Directives - non-life and life insurance)

On 1 December 2004, the Commission commenced proceedings in the European Court of Justice against Greece.

The Commission claims that the European Court of Justice should declare that Greece has failed to fulfil its obligations under Non-life and Life Insurance Directives 2002/13/EC (amending Directives 73/239/EEC and 2002/83/EC respectively). The basis for the Commission's claim is that Greece has failed to adopt the Directives as regards the provisions relating to solvency requirements for insurance undertakings, or, in any event, to notify the Commission of the relevant provisions. The deadline for implementation was 20 September 2003.

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

Case 522/04 (taxation - freedom to provide services - freedom of establishment - free movement of capital)

On 23 December 2004 the Commission brought an action in the European Court of Justice against Belgium. The Commission claims that certain requirements of Belgian tax law are in breach of Treaty internal market provisions.

The Belgian income tax code provides that:

- (i) employers' contributions to pension plans are deductible, and employees' contributions made by deduction from remuneration are subject to a reduction of tax, only if paid to an undertaking established in Belgium;
- (ii) transfers of pension fund moneys to a taxpayer who had previously moved his residence abroad are deemed to have been

made immediately before he moved abroad. This results in a requirement for the insurer to withhold tax on the transfer, even where bilateral tax agreements are in place under which another contracting State has the right to tax such income; and

- (iii) transfers of benefits accumulated within a Belgian pension fund to another pension fund or insurer established outside Belgium are subject to tax, whereas such a transfer within Belgium would not be so subject.

The Commission considers these measures breach various Treaty provisions relating to:

- the freedom to provide services ((i) and (ii) above);
- the freedom of establishment ((i), (ii) and (iii)); and
- free movement of capital ((i), (ii) and (iii)).

In addition, the Commission claims that the Belgian general regulation on stamp duty requires a foreign insurer without an operational headquarters in Belgium to appoint a Belgian resident tax representative to assume personal responsibility for annual taxes on insurance contracts. The Commission considers that this breaches the Treaty provisions relating to freedom of establishment.

There are also, in the Commission's opinion, breaches of the freedom of movement of workers.

Finally, the Commission claims a breach of Article 5 of the Life Insurance Directive (2002/83/EC), which provides that authorisation in one Member State entitles an insurer to carry on business in the Community on a services or establishment basis; and Article 53(2), which requires Member States to provide for insurers established in their territory to transfer all or part of a portfolio to a transferee established in another Member State.

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

10.3 Opinions

Case C-446/03 (corporation tax relief - freedom of establishment)

On 7 April 2005, Advocate General Poiares Maduro delivered his opinion in the case of *Marks*

& Spencer plc v David Halsey (HM Inspector of Taxes).

UK corporation tax restricts a company from claiming a reduction in its tax bill under the 'group relief' regime for losses suffered by a subsidiary outside the UK.

Group relief in respect of losses of subsidiaries in other Member States was refused on the ground that it does not apply to subsidiaries which are neither resident nor economically active in the UK. *Marks & Spencer* commenced proceedings against the Inspector of Taxes. The High Court ultimately referred the question whether the UK provisions are compatible with Community law to the European Court of Justice.

The Advocate General considered that the refusal to make a tax advantage available to certain companies, resulting in dissuading companies established in the UK from establishing subsidiaries in other Member States, constitutes an "exit restriction" and restricts freedom of establishment.

It was necessary therefore to consider whether the restriction could be justified on the ground of general interest. In his opinion:

- the argument that taking into account foreign losses would lead to a reduction in tax revenue and thus budgetary difficulties should be rejected;
- the principle of territoriality cannot justify the restriction, as the parent company resident in the UK is subject to unlimited fiscal obligations in that country, and the relief could be extended to parents with non resident subsidiaries;
- in order to argue the need to preserve the coherence of a tax system there must be a direct connection between the grant of a fiscal advantage and the offsetting of that advantage by a specific charge to tax;
- although a group relief scheme, whereby the foreign subsidiary could benefit from both that relief and an analogous relief in its home State, could give a two-fold advantage, the UK's general prohibition exceeds what is necessary to preserve cohesion and is acceptable only if foreign losses were accorded treatment equivalent to group relief in the Member State where the losses arose; and

- the benefit of the relief must be subject to the condition that the losses of foreign subsidiaries cannot receive similar tax advantages in the State in which they are resident.

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

11. EFTA Court

11.1 Initiation of Proceedings

Case E-1/05 (life insurance - completion costs)

On 11 January 2005, the EFTA Surveillance Authority brought an action against Norway concerning its failure to fulfil its obligations under Article 33 of the Life Insurance Directive (2002/83/EC).

Under the relevant Article, the EEA State of the commitment shall not prevent a policyholder from concluding a contract with a duly authorised assurance company, unless that would be contrary to legal provisions protecting the general good in the State of the commitment.

Norwegian legislation requires foreign assurance companies to calculate, and require payment of, "completion costs" (cf. establishment charges) in order to market their products in Norway. In effect, this means that establishment charges must be paid up front and cannot be deferred. The EFTA Surveillance Authority claims that this requirement:

- limits consumer choice by preventing policyholders from entering into contracts with assurance companies that allocate/defer completion costs over a period of time; and
- potentially limits the provision of assurance services in Norway by companies duly authorised in other EEA States.

EFTA Court judgements are not binding to EU Member States but are persuasive and are

generally followed by national courts. This case would, therefore, have repercussions in the way similar "completion costs" systems are dealt with in the EU Member States.

Timeline: The EFTA Court will generally rule on a case brought by the Authority within a year of the submission of the application to the Court. The deadline for intervention in this case is 10 June 2005. The hearing of the case is expected to be scheduled some time in the autumn.

12. Calendar of Events

27-28 April 2005

European Parliament plenary session (Brussels) (including adoption of van den Burg report on integration of EU financial markets)

27 April 2005

European Commission meeting (Brussels)

3 May 2005

European Commission meeting (Brussels) (including adoption of Green Paper on integration of financial services 2005-2010)

9-12 May 2005

European Parliament plenary session (Strasbourg) (including adoption of Skinner report on reinsurance)

9 May 2005

EP Committee on Economic and Monetary Affairs

10 May 2005

European Commission meeting (Strasbourg)

13-14 May 2005

Informal Ecofin Council meeting (Luxembourg)

18 May 2005

European Commission meeting (Brussels)

25 May 2005

European Commission meeting (Brussels)

25 May 2005

EP Committee on Economic and Monetary Affairs (including "European economic policy: a national and European perspective" Inter-parliamentary debate with national parliaments)

25-26 May 2005

European Parliament plenary session (Brussels)

29 May 2005

French referendum on EU Constitution

1 June 2005

European Commission meeting (Brussels)

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