

EU Financial Services BRIEFING



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1. Green Paper on Financial Services Policy (2005 - 2010)

On 3 May, the European Commission published a Green Paper setting out its objectives for financial services policy for 2005 - 2010 as follows:

- consolidation of progress towards an integrated European financial market;

- removal of remaining barriers;
- fostering an EU market where financial services and capital circulate freely at the lowest possible cost - with high levels of prudential control, financial stability and consumer protection;
- implementation, enforcement and continuous evaluation of existing legislation;
- deployment of the better regulation agenda for future initiatives;
- enhancing supervisory convergence; and
- strengthening European influence in global financial markets.

The following are identified as financial services policy priorities:

- completion of measures on clearing and settlement, reinsurance and solvency;
- decision on introducing additional regulation on rating agencies and financial analysts;
- completion, by the end of 2005, of the legal assessment of a proposal for implementation of the Hague Convention on conflicts of law in determining proprietary rights for securities held by an intermediary;
- possible, targeted new initiatives on:
 - asset management (Green Paper expected in July 2005),
 - retail financial services,
 - mortgage credit,
 - financial mediation,
 - bank accounts and
 - codification/simplification of information requirements rules.

Timeline: The Green Paper is open to public consultation until 1 August 2005. A White Paper will be presented in November 2005.

2. Commission issues Markets in Financial Instruments Consultations

On 13 May, the Commission published a second working document on the implementation of Articles 13 and 18 of Directive 2004/39/EEC on Markets in Financial Instruments. In particular, the document deals with the:

- organisational requirements for investment firms (Article 13(2), (4) and (5));
- records requirements for investment firms (Article 13(6));
- safeguarding of client funds and financial instruments requirements (Article 13(6)); and
- conflict of interest measures (Articles 13 and 18).

In addition, on 13 June 2005, the Commission published a working document on the implementation of Articles 22(2), 27 - 30, 40 and 44-45. The document deals with:

- pre-trade transparency obligations for regulated markets and multilateral trading facilities (Articles 29 and 44);
- pre-trade transparency obligations for systematic internalisers (Articles 4 and 27);
- post-trade transparency obligations for regulated markets, multilateral trading facilities and investment firms (Articles 28, 30 and 45); and
- conditions applicable to the admission of financial instruments to trading on a regulated market (Article 40).

The working papers are based on the CESR's technical advice given in response to requests by the Commission.

Timeline: *The deadline for responses to the Commission's consultation in relation to Articles 13 and 18 is 17 July 2005; and for Articles 22(2), 27 - 30, 40 and 44-45 is 16 August 2005.*

3. Parliament Resolution on the Integration of Financial Services

On 28 April, the European Parliament ("EP") adopted a resolution on the "current state of integration of EU financial markets." It recommended the extending consultation to

include consumers and users. It also encourages non-legislative and international, i.e. not solely EU, solutions for financial markets.

The EP emphasised the importance of convergence of Member States' supervisory and regulatory systems and presented the possibility of a two-tier EU level supervisory system for large cross-border players, without distorting the level playing field for other cross-border and local players. It also proposed a voluntary, bottom-up approach, to encourage a European standard and the concept of a "lead" supervisor with cross-border powers.

It recommends Commission action on:

- cross-border capital-raising from sophisticated investors and investment by venture capital funds;
- the concentration of European stock exchanges;
- supplementary pension fund investments;
- hedge funds; and
- reviewing the impact of the Distance Marketing Directive on cross-border business.

4. Parliament approves Cross-border Mergers Directive

On 10 May, the EP approved the proposed Directive on cross-border mergers. amendments adopted by the Parliament include:

- Member States may exempt cooperative societies from the scope of the Directive;
- the Directive will not apply to Undertakings for Collective Investments in Transferable Securities (UCITS);
- additional requirements for information which must be contained in the common draft terms of cross-border mergers e.g. the effects of the merger on employment, etc.;
- specific arrangements to be put in place for the new company in relation to employee participation if the arrangements which previously applied vary between the States in question.

Timeline: *The amended text will now be forwarded to the Council.*

5. Council approves Money Laundering Directive

The European Commission's proposal for a Third Directive on money laundering was approved by the European Council on 7 June. The Council adopted the proposal with certain amendments, including:

- financial institutions must identify the beneficial owners controlling at least 25% of a customer;
- terrorist financing is defined as a separate offence to money laundering as it may be funded through legal sources;
- the insertion of certain waivers, e.g. in life insurance and the opening of bank accounts, from the obligation to verify a customer's identity before the execution of a transaction or establishment of a business relationship;
- the insertion of a waiver, for existing anonymous accounts, from the prohibition of anonymous accounts;
- an increase in the threshold for reporting on beneficial ownership, from 10% to 25% plus one share;
- a revised definition of "politically exposed person"; and
- enhanced supervisory powers for competent authorities in the case of credit and financial institutions, including the right to conduct on-site inspections.

Timeline: The Directive will be implemented in the Member States within two years of its publication in the Official Journal which is expected to take place towards the end of 2005.

6. OECD adopts Insurance and Pension Funds Guidelines

On 28 May, the OECD approved new guidelines for insurers and pension funds. The OECD's objective is to strengthen investor and customer confidence and protection in the wake of recent scandals affecting the two sectors.

The Guidelines for Insurers' Governance relate to:

- board structure and responsibilities;

- the integrity and accountability of board members to shareholders and/or policyholders and/or competent authorities;
- legal liability of the board members for their actions and decisions;
- internal control and reporting systems, and the use of an independent actuary;
- the certification of accounts by an independent external auditor at least once a year;
- disclosure of information on the insurer's financial position and its exposure to financial and technical risks; and
- redress through the regulator or courts.

The Guidelines for Pension Fund Governance establish principles for:

- fund managers' accountability for protection of members' and beneficiaries' interests;
- accountability, integrity and experience requirements of fund governing bodies;
- transparency and clear communication between fund managers and plan members; and
- a strengthened role for actuaries and auditors as whistleblowers.

The Guidelines offer direction but are not binding or a standard.

Timeline: The Guidelines were adopted by the OECD Council on 28 May 2005.

7. European Parliament adopts Reinsurance Directive

On 7 June, the European Parliament adopted, at its first reading, the proposed Reinsurance Directive, subject to amendments. The proposal introduces a harmonised regulatory framework for reinsurance in the EU, based on the "home country" principle. The proposal provides for a similar regime to that applied to direct insurance, and will remove the remaining barriers to trade within the EU e.g. collateral requirements.

The Parliament has inserted amendments relating to special purpose vehicles and other technical clarifications and improvements.

Timeline: *The amended proposal will now be considered by the Council. If the Council approves the text with the Parliament's amendments, the Directive will be adopted in a single reading. The Member States must implement the Directive within two years of its final adoption. However, the European Parliament has proposed a transitional period of 12 months for compliance with the abolition of collateral requirements, in addition to the two years provided for the application of the Directive as a whole.*

8. Commission proposes Directive to extend MiFID's Transposition Deadline

On 20 June, the European Commission proposed a Directive amending the Markets in Financial Instruments Directive (2004/39/EC) in order to extend by 6 months:

- the deadline by which Member States must transpose the MiFID into national law; and
- the time granted to firms, after transposition into national law, for adaptation of their systems and internal procedures to comply with the requirements of the Directive.

The proposal applies to the whole Directive and not just the provisions that will need to be supplemented by implementing measures. The decision to extend the deadline meets Member State and industry concerns over the implementation of MiFID. It will give Member States more time to prepare implementing measures whose complexity and volume will make earlier adoption impractical. The proposed Directive would also delay the repeal of the Investment Services Directive.

Timeline: *The Commission expects to adopt the necessary implementing measures by the beginning of 2006. Member States must transpose MiFID by 30 October 2006. Firms must adopt the relevant changes to their structures by 30 April 2007.*

9. European Court of Justice

9.1 Preliminary Ruling Reference

Case C-513/04 (freedom of movement of capital - dividend tax)

Referring Court: Rechtbank Eerste Anleg te Gent (Ghent Court of First Instance) (Belgium)

Parties: Kerckhaert-Morres, Belgian State

The question referred to the European Court of Justice relates to Article 56(1) EC, which prohibits all restrictions on the movement of capital between Member States and between Member States and third countries.

The Belgian court has asked whether Article 56(1) precludes income tax legislation under which, although dividends from shares in a company established in the relevant Member State and from shares in a company not established in that State are subject to a uniform rate of tax, no deduction of tax at source levied in that other Member State is allowed in respect of dividends from companies not established in that State.

Timeline: *The question was referred on 15 December 2004. No date has yet been set for the hearing of this case.*

9.2 Judgements

Case C-22/03 (indirect taxes on the raising of capital - gross profits of securities intermediaries)

On 10 March, the European Court delivered its judgement following the reference for a preliminary ruling under Article 234, EC Treaty by the Rechtbank te Rotterdam in the case of *Optiver BV and Others v Stichting Autoriteit Financiële Markten*.

The preliminary ruling was made in the course of proceedings brought by Optiver BV and other securities intermediaries established in the Netherlands against the *Stichting Autoriteit Financiële Markten* (the "AFM"). The action concerned the levying of a duty on the companies' gross profits on income derived from securities. The companies maintained that the duty was contrary to Article 11 of Directive 69/335/EEC on indirect taxes on the raising of capital, which provides that Member States must not tax the creation, issue, admission to quotation on a stock exchange, making available on the market of, or dealing in, securities.

The AFM maintained that the duty applied to the income obtained from operations carried out in relation to securities and not from dealing in securities. In the alternative, it falls under the exceptions in Article 12(1)(a) and (e) of the

Directive, which exempt duties on the transfer of securities and those paid by way of fees or dues.

In its judgement the European Court upheld the duty by interpreting Directive 69/335/EEC to mean that it does not preclude the levying on securities intermediaries of a duty, such as that in issue, on the gross profits from activities related to those securities.

Timeline: *The Dutch referring court (and national tax authorities) will now apply the ruling to this and other similar cases.*

Case C-465/03 (Sixth VAT Directive - deductibility of VAT - supplies for consideration - share issue - admission to stock exchange)

On 26 May, the European Court delivered its judgement following the reference for a preliminary ruling under Article 234, EC Treaty by the *Unabhängiger Finanzsenat, Aussenstelle Linz* (Austria) in the case of *Kretztechnik AG v Finanzamt Linz*.

The preliminary ruling was made in the course of proceedings brought by Kretztechnik against Finanzamt Linz, the tax authority. In January 2000, Kretztechnik increased its capital by issuing new shares and was admitted to the Frankfurt Stock Exchange. It paid VAT on all the supplies it received to achieve the increase and admission. The tax authorities subsequently refused to allow deduction of VAT input tax on the ground that a share issue is not exempt from VAT.

The Austrian court asked the Court of Justice to rule as to whether:

- upon being admitted to a stock exchange, a company carries out a transaction for consideration within the meaning of the Sixth VAT Directive when it issues shares for new shareholders against payment of an issue price; and
- the Directive confers a right to deduct input tax paid on the supply of services connected with the taxable transactions.

The Court ruled that:

- a new share issue does not constitute a supply of services for consideration within the meaning of Article 2(1) of the Directive, as only activities of an economic nature are subject to VAT. The issue of new shares takes place in order to increase capital and not to provide services, therefore, payment

of the requisite sums does not amount to payment of consideration, but an investment of capital; and

- Article 17(1) and (2) of the Directive confer the right to deduct VAT charged on expenses incurred by a taxable person for supplies acquired by him in connection with a share issue, provided that all the transactions undertaken by the taxable person in the context of his economic activity were taxed transactions, and were overheads and therefor component parts of the price of its products. The input transactions must have a direct and immediate link with the output transactions conferring the right to deduct. In this case Kretztechnik carried out the share issue to increase its capital for the benefit of its economic activity in general. The costs relating to the issue, therefore, form part of its overheads and are components of the cost of its products.

If a taxable person effects transactions that give rise to a right of deduction and transactions which do not, the deduction is proportional.

Timeline: *The Austrian referring court (and national tax authorities) will now apply the ruling to this and other similar cases.*

Case C-376/03 (freedom of movement of capital; wealth tax)

On 5 July the Court of Justice delivered its judgement in *D. v Inspecteur van de Belastingdienst/ Particulieren/ Ondernemingen buitenland te Heerlen*.

D, resident in Germany, held property in the Netherlands, which was subject to wealth tax in that State. This property represented 10% of D's wealth. Under Dutch law resident taxpayers, and non residents who hold 90% of their wealth in the Netherlands, are entitled to a deductible allowance. D claimed that, due to denial of the benefit of this allowance, he was being discriminated against, contrary to Articles 56 and 58 EC Treaty.

The questions referred to the Court included:

- whether Community law precludes national legislation whereby, where a non resident taxpayer's assets are predominantly in his country of residence, he may not benefit from an allowance which is available to domestic taxpayers;

- if not, whether it makes a difference that under a bilateral tax treaty between the Netherlands and Belgium a non resident taxpayer may benefit from the allowance.

The Court followed *Schumacker*, in which it was accepted that the situations of residents and non residents are generally not comparable. Therefore, not granting an allowance to non residents that is granted to resident taxpayers is not necessarily discriminatory. This applies in the case of wealth tax as for income tax. The fact that the taxpayer's State of residence does not apply wealth tax is irrelevant. The Court distinguished *Wallentin* on the basis that the amounts paid to the non resident taxpayer in that case did not constitute taxable income in Germany - Messrs. Wallentin's and D's situations were not comparable.

On the second question the Court held that it is inherent in the nature of bilateral tax treaties that reciprocal rights and obligations under such treaties apply only to residents of one of the two States involved. Therefore, a person resident in Belgium is not in a situation comparable to that of a person resident in a State not party to the Netherlands-Belgium treaty.

The Court held:

- Articles 56 and 58 did not prevent a Member State from denying entitlement to allowances available to resident taxpayers to non resident taxpayers with the major part of their wealth in their State of residence
- Articles 56 and 58 do not preclude a rule in a bilateral tax treaty such as that in issue from not being extended to nationals of a State which is not party to the treaty in question.

It should be noted that the Court did not follow the Opinion of Advocate General Colomer who had proposed, in the first question, that denial of an allowance is precluded where assets owned in other States are not subject to a similar tax.

Timeline: *The case will now be referred back to the national court.*

9.3 Proceedings by Commission

Case 47/05 (life insurance - pensions - tax)

On 7 February the Commission brought infringement proceedings Court against Spain.

The Commission claims that Spain has failed to fulfil its Treaty obligations by adopting and maintaining in force a system which applies tax concessions in relation to life insurance and pensions only to contributions paid under contracts concluded with undertakings established in Spain and not to those paid under contracts concluded with Community undertakings not established in Spain.

The Commission considers that the relevant Spanish law, by imposing a requirement of establishment, is a restriction on the freedoms in Articles 39, 43, 49 and 56 EC Treaty (free movement of workers; freedom to provide services; free movement of capital).

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

10. Calendar of Events

7 July 2005	Meeting of ECB Governing Council
10 July 2005	Referendum on EU Constitution in Luxembourg
11 July 2005	Eurogroup meeting
12 July 2005	Ecofin Council meeting (presentation of Council Presidency Ecofin work programme)
12-13 July 2005	EP Committee on Economic & Monetary Affairs (Gordon Brown to present UK Ecofin priorities)
13 July 2005	European Commission meeting (Brussels)
15 July 2005	Ecofin Council meeting (devoted to 2005-2006 budget)
18 July 2005	Commission Conference on Financial Services Policy Green Paper
20 July 2005	European Commission meeting (Brussels) (last meeting before summer break)
21 July 2005	Meeting of ECB Governing Council
1 August 2005	Consultation closes on Financial Services Policy Green Paper

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