bankenverband
BUNDESVERBAND DEUTSCHER BANKEN

Response to the European Commission
Green Paper

“Financial Services Policy 2005-2010”

of 3 May 2005

Berlin
29 July 2005

Table of contents

Summary

1. Overall policy objective and key political orientation
1.1 Overall objectives and general comments on discussed key measures
1.2 Synergies with competition and consumer policy

2. Better regulation, transposition, enforcement and continuous evaluation
2.1 Optimising rules and regulations at European and national level
2.2 Consolidation of the regulation of the securities markets
2.3 Realistic deadlines
2.4 Mediation and alternative dispute resolution
2.5 Reducing overregulation
2.6 Better co-ordination between the committees
2.7 Single Financial Services Rulebook

3. Consolidation of financial services legislation over the 2002-2010 period
3.1 Remaining measures
3.2 Efficient and effective supervision
3.3 Barriers to cross-border mergers and acquisitions / enabling cross-border investments and competition
3.4 The external dimension

4. Retail financial services / possible targeted new initiatives

5. Need for further action

Annex 1: Better regulation for the financial services sector
Annex 2: The three-step evolutionary approach to supervising financial services
Annex 3: Barriers to cross-border mergers and acquisitions
Annex 4: Regulatory dialogues with specific third countries
Annex 5: Specific issues connected with the regulation of bank accounts
Annex 6: Further tax regulation needed

Summary

- The Association of German Banks regards the Green Paper's focus on the application of a "**better regulation**" approach as exceptionally important. The envisaged regulatory impact assessments will play a key role in this context. We therefore warmly welcome the "Impact Assessment Guidelines" published by the Commission on 15 June 2005[1]. It should not be overlooked, however, that regulatory impact assessments have certain method-ological weaknesses. A definitive quantification of the costs and benefits of financial market legislation is difficult to obtain. So although impact assessments can be a useful accessory tool in the legislative process, there is no substitute for political analysis and evaluation of new ideas.
- The Financial Services Action Plan (FSAP) of 1999 was rigorous in tackling the integration of wholesale and securities markets. While there is most certainly a need in these sectors for a phase of consolidation – coupled with an emphasis on implementation, convergence and enforcement – this is not the case in other areas. The time has now come to address the **integration of retail markets**, the **elimination of obstacles to cross-border consoli-dation and the creation of an efficient and effective European supervisory system**. It is regrettable that the Green Paper falls short of expectations on this last point. It fails to put forward a coherent strategy for overcoming the inefficiencies of supervisory practices in the European Union (EU) in the coming years.
- The European banking industry intends to create a **Single Euro Payments Area (SEPA)** by the year 2008. The Association of German Banks is, however, very firmly in favour of leaving migration beyond 2008 – that is, the transition to full replacement of national payment systems by the SEPA instruments – to the market. Such a complex process, with its far-reaching economic effects, should not be dictated by legislators, particularly as not only do banks face heavy investment but customers would, in the end, have to pay the extra costs.
- With regard to the **clearing and settlement**, we believe that here, too, there is no need for any legislative action beyond that which is necessary to dismantle the legal and tax barriers identified by the Giovannini Group.
- While the Association of German Banks considers that the most effective strategy for an integrated **retail market** would be successive full harmonisation of those areas of law which are particularly relevant to doing business across borders (concept of targeted harmonisation), we believe that the introduction of a product-based 26th regime might offer a means of filling the existing gaps in the legal framework governing cross-border transactions. This idea should therefore be given careful consideration, while not

[1] European Commission, "Impact Assessment Guidelines" (SEC/2005/791) of 15 June 2005.

overlooking the fact that certain questions would need to be solved, such as how to define unequivocally the interface between 26th regimes and national laws, which would continue to exist. Germany's private banks strongly support the Commission's intention ultimately to create a coherent European contract law.

- The idea raised in the Green Paper of consolidating all financial services legislation in the EU into a sort of "**single rulebook**" would offer a suitable means of eliminating inconsistencies and overlaps of individual EU rules and make them easier to apply. We strongly support the planned deepening of **EU financial markets regulatory dialogues with important third countries such as EU accession candidates and neighbouring countries, the US, Japan, Switzerland, China and India**. The Commission's intention to draw more on market participants' input is also welcomed. At the same time, **EU common trade policy** should continue to address discriminatory financial regulation in more emerging market countries than the regulatory dialogues would be able to focus on, mainly via the multilateral WTO negotiations and in close consultation with the European banking sector.
- It is disappointing that the Green Paper fails to propose any further measures to improve the **tax environment**. It thus leaves it up to the European Court of Justice to remove ex post obstacles such as aspects of company taxation, the VAT treatment of financial services and the taxation of private capital income from cross-border transactions.

1. Overall policy objective and key political orientation

The Commission would be interested to hear from stakeholders:

- *whether they agree with the overall objectives for the Commission's policy over the next five years;*
- *whether they agree with the key political orientation described.*

1.1 Overall objectives and general comments on discussed key measures

The Association of German Banks fully supports the overall objectives of the Commission's financial services policy.

Retail banking

Virtually no progress has been made up to now on the integration of the **retail banking** markets. The potential of an EU market with 450 million citizens is being insufficiently exploited. The **Association of German Banks welcomes the Commission's intention** to continue moving forward the integration of Europe's financial services markets, especially in the retail area, where consumers are still prevented from reaping the full benefits of the European retail market. The continuing fragmentation of the retail banking market is not – as is sometimes claimed – due to consumer preference to operate locally. Consumers in the Internet age are no longer tied to banks located in their area, but can, in principle, choose freely from all financial services providers. But they still face the obstacle of the legal uncertainty associated with doing business across borders. It should not be overlooked that even where action has already been taken at EU level to harmonise the legal framework, the resulting national rules and their interpretation frequently differ considerably from one member state to another. The minimum harmonisation approach pursued up to now – particularly in the area of investor and consumer protection – has not proved successful. National implementation diverges too widely to enable consumers and suppliers to benefit from the internal market.

These barriers to cross-border business must be eliminated and consistent, pan-European solutions found. The right way forward, in our view, is to proceed with successive full harmonisation of those areas of law of particular relevance to doing business across borders (**concept of targeted harmonisation**).

European supervisory structures and the Lamfalussy process

The internationalisation of the banking sector is far advanced. Big banks have today centralised key management functions such as liquidity, capital and risk management; decisions are taken with the entire group in mind. The implementation of Basel II will

reinforce these developments. In consequence, many financial services institutions can no longer be monitored by national regulators alone. **Europe's supervisory system** must reflect this. We believe the evolutionary approach discussed in the Green Paper is too abstract and imprecise for this purpose, however. The **three-step model** proposed by the Commission contains no concrete measures to create efficient and effective supervision. It is therefore to be hoped that the upcoming White Paper will put forward a coherent plan with a list of specific measures and an implementation timetable. As the next step, we advocate agreement on a **lead supervisor system**. The ultimate goal, in our view, should be the creation of a **European System of Financial Services Authorities (ESFSA)** with a supranational agency at its head modelled along the lines of the European System of Central Banks.

The **Lamfalussy process** has proved to be a valuable means of promoting co-operation between national supervisory authorities in the EU and has done much to make the legislative process swifter and more flexible. It is too soon, however, for a definitive assessment since only a few measures have been adopted under this procedure. The extension of the Lamfalussy process to the banking and insurance sectors has our full support. Nevertheless, the differences in the speed of member states' implementation of measures passed up to now, such as the Market Abuse Directive and the Prospectus Directive, are unacceptable. Effective steps should be taken vis-à-vis those member states which are lagging behind and it should be ensured in future that legislation is implemented in parallel.

Furthermore, there is a need for prompt inter-institutional agreement on the European Parliament's right of recall at Level II so that it will have the role in the legislative process envisaged in Article I-36 of the European Constitution. This step will also be made necessary by the sunset clauses which will begin to take effect from April 2007.

<u>Obstacles to cross-border mergers and acquisitions</u>

The Association of German Banks supports the Commission's approach of examining the extent to which **obstacles to cross-border mergers and acquisitions in the EU** are responsible for cross-border business in financial services falling short of its potential. We feel it is significant that, while private banks in Germany are not able to acquire public-sector financial institutions, it is perfectly possible for a bank in public ownership to take over a private one. This not only distorts competition on the national market but hinders the cross-border movement of capital within the EU.

1.2 Synergies with competition and consumer policy

Economic momentum and prosperity in the EU can only be ensured if citizens and companies are free to take their own decisions and markets are able to function. The legal environment must therefore allow the greatest possible scope for initiative and personal responsibility.

Consumer policy

It is therefore to be welcomed that consumer policy is to figure in financial market legislation in the sense of promoting the **concept of the responsible consumer**. Effective competition and market transparency are absolute prerequisites for ensuring that consumers are offered a wide choice of inexpensive and high-quality products and services. The primary objective of consumer policy should consequently be to create an environment in which consumers can access comprehensive and objective information. Only informed and responsible consumers can permit competition to operate with maximum effectiveness through the price mechanism. Consumer policy is thus about more than consumer protection. The protective role is the – naturally indispensable – final step if other consumer policy tools, such as consumer information and consumer education, no longer function efficiently.

Competition policy

Market economy decision-making processes are frequently encumbered, distorted or even suppressed by state interference. Since the integration of Europe's financial services markets cannot be achieved without greater institutional integration, we welcome the **targeted and appropriate horizontal incorporation of competition policy** into this ongoing process.

The European Commission recently launched **sectoral enquiries in the financial services field**, initially focussing on payment card systems. It is in the interests of the European banking industry as a whole for there to be no artificial insulation of national markets. The Commission's investigations are therefore to be welcomed in principle. Germany's private banks will provide constructive input from the outset.

2. Better regulation, transposition, enforcement and continuous evaluation

The Commission would be interested to hear from stakeholders:

- *whether they agree with the priority measures identified; and*
- *which additional measures should be taken to foster consistent application and enforcement of European legislation.*

2.1 Optimising rules and regulations at European and national level

A major challenge facing the European institutions, member states and supervisory committees is to **consolidate** the existing body of rules and regulations and achieve **consistency among** the **principles and definitions** they contain without undermining current and future impetus for further integration of the internal market. Member states should be

supported in their efforts to promote and comply with these objectives without creating an excessive number of new rules when transposing EU legislation into national law.

We welcome the fact that the 2005-2010 financial services policy agenda envisages performing **impact assessments** on both existing legislation and new proposals. Nevertheless, we feel that the institutional framework created by the Commission is insufficient to assure the impact assessment's success. It must also be stressed that a regulatory impact assessment is not a magic bullet. The costs and benefits of financial market legislation are difficult to quantify in absolute terms. Nor should qualitative aspects be ignored, such as the contribution a new piece of legislation can make to the stability of the financial markets, the EU's competitiveness as a business location or to investor confidence. Such factors are extremely difficult to measure. So although impact assessments can play a useful supporting role in the legislative process, there is no substitute for political analysis and evaluation of new ideas. The Association of German Banks has drawn up some guidelines, outlined in **Annex 1** of this position paper, for establishing an impact assessment system at EU and member state level.

The better regulation approach should also be applied to the upcoming revision of the **Consumer Credit Directive**. Rigorous application of better regulation principles would keep state interference in the workings of the market to a minimum. Effective competition is still the best form of consumer protection. Should a particular area lack market transparency for the consumer, it is up to legislators to take the appropriate steps to create transparency and thus effective competition. Excessive regulation, which weakens competition by providing disincentives or even barriers to offering banking products and services, should be avoided. The same goes for the creation of new, unclear legal terms or comparison criteria which give rise to high transaction and bureaucratic costs without really increasing market transparency for the consumer. Targeted impact assessments would be able to identify the adverse effects of overregulation ex ante and thus avoid inappropriate interference in the market.

The Market Abuse Directive's rules on **financial analysts** would also benefit from the application of better regulation principles. The Association of German Banks welcomes the fact that the Commission is planning no further measures. It should be borne in mind that financial analysts are already subject to numerous impractical rules and regulations under the Market Abuse Directive.

2.2 Consolidation of the regulation of the securities markets

We warmly welcome the intention to consolidate what has been achieved so far in terms of securities markets regulation. Member states and industry will be primarily concerned in the near future with implementing the FSAP measures. It is therefore quite right for the

Commission also to wish to focus on their actual **transposition** into national law, on co-ordinating this process, and on **evaluating and enforcing** implementation by member states. Transposition workshops will play a valuable role in fostering greater awareness and acceptance of national implementation.

2.3 Realistic deadlines

The Commission's intention to set realistic transposition deadlines in future is to be welcomed. The proposal for a **directive extending the deadline for transposition of the Markets in Financial Instruments Directive (MiFID)** is therefore both consistent and necessary. It must always be ensured in such circumstances that the extension will benefit not only legislators and supervisory authorities, but also market participants.

2.4 Mediation and alternative dispute resolution

Securities sector

Dispute resolution mechanisms such as those currently under discussion by the Committee of European Securities Regulators (CESR) are potentially an appropriate means of accelerating the process of integration. It is important for any such mechanism to operate within the existing constitutional framework. In particular, it must be compatible with the role of the European Commission at Level 4 and of the European Court of Justice. The sovereignty of the member states and their judiciaries must also be respected. Unless changes are made to the existing legal system, therefore, the **mediation will have to be non-binding**.

Accounting

Primary responsibility for adopting and interpreting accounting rules lies with the standard setters and their interpretation committees, such as the International Financial Reporting Interpretations Committee (IFRIC). The enforcement of accounting standards is carried out by national enforcement agencies. **CESR's role is confined to co-ordinating enforcement in Europe**. There is only scope for further involvement by CESR in areas falling within the responsibility of neither the accounting standard setters nor the enforcement agencies. Accounting matters are therefore an issue concerning the future development of the financial services supervisory system only inasmuch as it would make good sense for the supervisory authorities to aim at an alignment of regulatory reporting requirements with disclosure obligations under International Financial Reporting Standards (IFRS). Duplication of reporting requirements should be avoided because it would create an additional administrative burden and make financial reporting more complex.

2.5 Reducing overregulation

It would be premature, at a time when implementation of the FSAP measures is as yet incomplete, to call for certain rules to be withdrawn. Nevertheless, a critical look should already be taken at areas which are **overregulated**. A case in point is the envisaged requirement under implementing measures of the MiFID for **voice recordings of all telephone calls between branches and clients**. It is also too soon at this stage, when the new legislation on prospectuses has only recently come into force, to call for a revision of the rules in the implementing Regulation No 809/2004 on "complex financial history". Fresh requirements would place an additional bureaucratic burden on issuers; a more flexible mechanism for the supervisory authorities would be preferable.

2.6 Better co-ordination between the committees

Germany's private banks fully support the view that better co-ordination is needed among the supervisory committees. We view it as a matter for concern that there is insufficient co-ordination at present between CESR and the Committee of Banking Supervisors (CEBS) on the **CESR-ESCB Clearing and Settlement Standards**, for example. The MiFID's rules on outsourcing also have a supervisory dimension and will require close co-ordination between the two committees.

2.7 Single Financial Services Rulebook

The idea of consolidating all financial services legislation in the EU into a sort of "**single rulebook**" would offer a suitable means of eliminating inconsistencies and overlaps of individual EU rules, thus making them easier to apply. It is not made clear, however, how national rules would be incorporated into the rulebook. It will have to be carefully examined whether a single rulebook for financial services would be able to meet the expectations that such an ambitious and complex project would raise.

3. Consolidation of financial services legislation over the 2002-2010 period

The Commission would be interested to learn from stakeholders:

- *whether they agree with the identified measures where the Commission might decide to take no action, or if there are other concrete areas where the Commission should not bring forward proposals presently in the pipeline or, indeed, areas where the Commission should consider withdrawing;*

- *their assessment if the existing regulatory and supervisory framework is sufficient to tackle the supervisory challenges in the years ahead, what are the gaps and how these can be filled most effectively;*
- *what are the objectives, sectors to be covered and the priority areas in regulatory and cooperative activities on a global scale.*

3.1 Remaining measures

Rating agencies

We share the Commission's view that rating agencies require no additional legislation at this stage. It would be preferable first to examine whether the current provisions in the Market Abuse Directive, self-regulation and monitoring mechanisms prove sufficient. We strongly support CESR's position, namely to see how the IOSCO Code of Conduct Fundamentals adopted in December 2004 function in practice before considering the creation of a binding pan-European regime for rating agencies. The Code of Conduct Fundamentals are a major step in ensuring that the agencies issue high-quality and reliable ratings. Nevertheless, given their importance for the smooth functioning of the financial markets and the special conditions of competition on the market for ratings, rating agencies should continue to be closely monitored.

Take-Over Bids Directive

The Association of German Banks welcomes the European Commission's statement that it will propose no implementing measures for the **Take-Over Bids Directive**. The need for implementing measures should be assessed on a case-by-case basis and the temptation to draft measures in the absence of a clear business case must always be resisted. An important factor to take into account in this respect is the competitiveness of the EU as a business location compared to other financial markets around the globe.

Other factors which have to be considered in this context are the results of the European Commission's evaluation of obstacles to cross-border mergers and acquisitions, the findings of the ECOFIN in November 2005 and the outcome of the Parliament's initiative report "Towards further integration and consolidation of European financial services".

Single Euro Payments Area (SEPA)

The creation of a Single Euro Payments Area (SEPA) is an important building block for the single European financial market. The Association of German Banks firmly supports the objective of gradually creating a **SEPA from 2008** in which bank customers will be able to make cross-border payments in euros just as simply, cost-efficiently and safely as national

payments today. The Association of German Banks underlines its commitment to SEPA through co-ordinated and consolidated cross-industry participation in the development of pan-European standards for the clearing and settlement of payments within the European Payments Council (EPC) set up in 2002. The SEPA project is also backed by the Initiative Finanzplatz Deutschland (IFD).

The target of persuading more than 6,000 banks in Europe to steer the same course on payment issues is, however, an ambitious one. Nevertheless, the Commission should give preference to a market-driven approach over interference through administrative measures: Any road to SEPA laid out by regulators would have negative consequences for all concerned, whether politicians, customers or banks.

Since being set up, the EPC has already passed a number of resolutions on cross-border payments – take credit transfers, for instance. These resolutions are implemented on a self-regulatory basis by the ever larger number of member banks. In December 2004, the EPC defined further important milestones on the way to the Single Euro Payments Area by adopting the “SEPA roadmap”. This shows that the process of gradual standardisation of payments in Europe is already being actively promoted.

This year the EPC will deliver the two new pan-European payment schemes for **electronic credit transfer and direct debit, plus a framework for the SEPA debit card**. European banks will make these new instruments available to their customers from 2008 onwards as additional services alongside existing national payment instruments.

The Association of German Banks is, however, very firmly in favour of leaving migration beyond 2008 – that is, the transition to full replacement of national payment systems by the SEPA instruments – to the market. Such a complex process, with its far-reaching economic effects, should not be dictated by legislators, particularly as not only do banks face heavy investment but customers would, in the end, have to pay the extra costs. The key to the success of SEPA will ultimately be customer demand. So the new payment instruments must not be less efficient and attractive than existing national instruments.

Creating SEPA is something the banking sector cannot manage on its own. A further factor in the success of this project – besides acceptance by customers – is close co-operation with the political institutions in order to create the legal conditions so that the SEPA instruments can be used from 2008 onwards on a binding basis for all concerned. The Association of German Banks therefore supports the European Commission’s initiative to create a **common legal framework for competitive payment services in the European Union**.

However, care should be taken not to overshoot the target. Europe’s still highly fragmented payments landscape and its widely differing payment habits mean that drafting sound common standards in the EU and developing efficient, inexpensive pan-European payment

instruments both take time. The Association of German Banks, the ZKA and the IFD's "Euro Payments" Working Group have set the course for the creation of SEPA through self-regulation. A look at the work performed to date shows there is every reason to feel confident that the milestones defined in the SEPA roadmap will be implemented just as quickly as other measures in the past. What is needed now is not further legal steps going beyond the action outlined – or the threat of these – but peace to press ahead with the wide-ranging tasks in hand on a secure basis and confidence in the banking industry's willingness to promote the SEPA project with the required urgency.

Clearing and settlement

We see no need at present for a directive dealing specifically with post-trade financial services (clearing and settlement). It would better in our view to intensify the work of the expert groups (CESAME, Legal Certainty Group, Fiscal Compliance Group/FISCO) set up by the European Commission and in this way to remove the barriers to cross-border securities clearing and settlement in the EU identified by the Giovannini Group.

Besides the **legal barriers, the tax barriers identified by the Giovannini Group** also require further evaluation. Specific tax barriers are raised by the complexity and diversity of the procedures in place, especially those to collect withholding tax and capital gains tax. In particular, all provisions stipulating that taxes on securities transactions must be collected via national settlement systems should be abolished.

Hague Convention

Any lengthy review of the arguments put forward against the *Hague Convention on the law applicable to certain rights in respect of securities held by an intermediary* must be rejected. The articles of this Convention are likely to guarantee a greater degree of legal certainty for those participating in global securities trading. This will help to make international book-entry securities business more efficient. The **Hague Convention should** therefore **be quickly signed and ratified**.

Asset management

In its May 2004 report[2] the Asset Management Expert Group proposed drawing up a separate list of measures to harmonise the transparency and distribution of investment funds. The Association of German Banks will comment separately on these in the course of the consultations running independently of the Green Paper. We would nevertheless like to stress our firm belief that any consideration of a new regime for **collective asset management** should examine to what extent **hedge funds** should be regulated at European or, even better, international level.

[2] See http://europa.eu.int/comm/internal_market/finances/docs/actionplan/stocktaking/report-assetmgnt_en.pdf.

3.2 Efficient and effective supervision

The internationalisation and growing complexity of the capital markets has triggered far-reaching restructuring of management functions and business processes. The creation of sophisticated risk-management systems can only take place centrally and at group level. To take these developments into account, there is a need for **one-stop, consolidated supervision of risk management**, too. The effective supervisory co-operation and greater consistency between regulators that the Commission calls for is absolutely essential, in our view, though by no means sufficient. We believe urgent consideration should be given to integrating Europe's supervisory systems. This is not a question of "rushing into" a more integrated system, as the Green Paper puts it. Our aim must be to take a forward-looking approach to what the Commission quite rightly describes as an evolutionary process.

The Association of German Banks welcomes the "evolutionary" three-step approach to adapting existing supervisory systems to reflect the way in which internationally active financial services firms now operate. Our views on how best to flesh out this approach can be found in **Annex 2**.

3.3 Barriers to cross-border mergers and acquisitions / enabling cross-border investments and competition

The European single market for financial services will be able to promote prosperity only when it becomes possible to provide such services across borders on a large scale and whenever it would be economically beneficial to do so. The acquisition (takeover) of, or merger with, a foreign financial institution are merely two, albeit very important, means for a bank to expand business beyond the borders of its own country.

Mergers and acquisitions complement other forms of offering financial services across borders, such as direct marketing abroad by post, telephone or internet, the establishment of legally dependent branches or independent foreign subsidiaries.

Mergers and acquisitions are not ends in themselves. Nor, in consequence, can promoting and facilitating mergers and acquisitions be considered a political objective in itself. The decisive point is the potential benefit for customers and consumers. From the customers' perspective, mergers or acquisitions offer two possible advantages. Economies of scale and economies of scope enable firms to supply retail and corporate customers more efficiently and with a wider range of financial services.

With this in mind, the Association of German Banks welcomes the European Commission's intention to analyse whether barriers to mergers and acquisitions in the financial services sector still exist in the EU.

The number of **direct legal obstacles** to mergers and acquisitions in the narrow sense is comparatively small; their significance can be extremely serious, however. **Indirect obstacles** are much more numerous. These are normally caused by rules and regulations which, while not directly standing in the way of mergers and acquisitions, nevertheless often make them unprofitable with the result that they never even get onto the drawing board. In these cases, any legal obstacles will make themselves felt only when the circumstances making a merger or acquisition economically unattractive have been eliminated.

In particular, the fact that much EU legislation is based on the concept of minimum harmonisation and that the country of origin principle does not always apply, especially where the economic activity of individuals and consumers is concerned, often prevents mergers and acquisitions from coming about. Transactions then frequently fail to take place even though, in a truly integrated single market for financial services, they would be profitable and increase prosperity.

Annex 3 of this position paper outlines the most important direct and indirect obstacles to cross-border mergers and acquisitions from our perspective.

3.4 The external dimension

International dialogue in general

We welcome and support the **Commission's intention of establishing and deepening regulatory dialogues with important third countries**. Problems of burdensome or discriminatory host regulation of European banks could be addressed and solved, or even avoided, more easily in such settings than by means of ad-hoc activities and talks. We also welcome the Commission's intention of **drawing more on market participants' expertise** and would be pleased both to co-ordinate input from our member banks and contribute via the European Banking Federation (EBF). **Member states' financial supervisory authorities should also be included in the dialogues, preferably within the framework of CESR and CEBS.**

EU common trade policy is rightly mentioned in its strong capacity to open up foreign financial markets for European banks by targeting remaining discriminatory or even prohibitive restrictions, in particular via the multilateral WTO negotiations. Both the Association of German Banks and the EBF are prepared to continue their close co-operation with the Commission in this field. As **resources for regulatory dialogues are limited, these have to focus on delivering results concerning a few major third countries**, while trade policy can address the discriminatory or prohibitive regulation of European banks not only in these countries but also in many more emerging market economies.

Enhancing European influence on the global stage and ensuring the global competitiveness of the European financial sector are laudable aims. We note, however, that the Green Paper deals only with the Commission's bilateral regulatory dialogues and EU common trade policy, both of which naturally constitute powerful instruments for achieving these objectives. Other instruments, such as European representation in international bodies, are not discussed. It should be borne in mind that the global competitiveness of European banks is dependent not only on their fair regulatory treatment abroad but also on their activities being governed by an efficient internal framework of EU and national law as well as on efficient co-ordination of EU and non-EU regulation. The three global regulatory objectives mentioned in Section V of Annex I are naturally to be supported.

Extension of European transparency standards to entities of European financial institutions in offshore financial centres

Section 1 of the Green Paper addresses **ethical standards** in policy areas that are, though outside the paper's scope, considered vital for building confidence and transparency in European financial markets, e.g. **corporate governance, company law, accounting, statutory auditing.** National supervisors are called on to ensure the application of such standards also to entities of European financial institutions established in offshore financial centres. It is not entirely clear whether this is meant to apply to any office type in any third country or only to certain types of offices and certain countries. A broad approach to the consolidated supervision of ethical standards would create the problem of burdensome or even conflicting double regulation by both the EU and those third countries which have ethical standards in place that differ from EU standards. The multilateralisation of standards or mutual recognition of their equivalence, e.g. between the IFRS and the US Generally Accepted Accounting Principles (GAAP), can be helpful in such cases but may be difficult and time-consuming to negotiate. To avoid unnecessary regulatory burden, the **consolidated EU member state supervision of such standards should be risk-based and therefore concentrate on offshore financial centres that do not have proper regulation in place and on offices types which are of significant concern for the EU parent financial institution with regard to the specific standard in question.**

Please see **Annex 4** for our comments on regulatory dialogues with specific regions and financial centres.

4. Retail financial services / possible targeted new initiatives

The Commission would be interested to learn from stakeholders:

- *whether they agree with the new identified priority areas;*
- *what are the (dis)advantages of the various models for cross-border provision of services, whether there is a business case for developing a 26th regime, and which business lines might benefit;*
- *how to enable consumers to deal more effectively with financial products and whether this means more professional and independent advice, improved education or financial literacy training are needed;*
- *whether they agree with the issues identified in the above list of retail products, or if they would suggest other areas where additional action at EU level could be beneficial.*

We welcome the fact that the European Commission wants to introduce simpler, more standardised legislation for dismantling barriers in the retail area. To solve the problem of diverging rules once and for all future measures should be based on **consistent basic principles for future consumer protection legislation**. These basic principles might be formulated along the following lines:

- **Quality not quantity –** meaning that suppliers should provide consumers with sufficient information to enable them to make an informed decision. This would include:
  - a description of the product, outlining its aim and purpose
  - associated risks
  - (future) financial commitments
  - extent of legal obligations
  - the cost, if any, of terminating the contract ahead of schedule
  - how to access further information / obtain personal advice.
- **Time for reflection** (prior to concluding the agreement or subsequent right of withdrawal).
- **"Individual" advice if desired, but no obligation**.
- **Simple customer complaint arrangements**.
- **No product harmonisation** (legislators must allow flexibility in product design).

26th regimes to overcome deficits in harmonisation

To remove the obstacle of differing national legal systems, the European Commission mentions so-called "**26th regimes**" as an alternative arrangement to stronger harmonisation of

national legal systems. These would be facultative European standards conceived merely for certain products, leaving national rules untouched.

While the Association of German Banks believes that this approach is worth considering, it feels that it should be taken into account that for customers and suppliers, 26th regimes, as well as other national legal systems, would in the beginning only be a further set of outside rules. Moreover, it would be difficult to define the "interfaces" between the rules of 26th regimes and national civil law and contract law. If 26th regimes were to be reduced to individual rules, this core law would be supplemented or obscured, particularly in the field of consumer protection, by 25 different national regimes. Large sections of national legal systems – in the area of civil, property or liability law, for instance – would continue to be applicable to agreements concluded under a 26th regime and might contain conflicting rules.

26th regimes could nonetheless have a useful transitional role to play. They offer an opportunity to try out standardised rules under real market conditions and can thus help to develop uniform consumer expectations in the EU and point the way towards further full harmonisation.

Germany's private banks consider it important not to lose sight of the systematically sounder approach of full harmonisation of aspects of law with particular relevance to doing business across borders. The European Commission should stick firmly to the plan to create a "coherent European **contract law**" it has already adopted by setting up CFR-net. The obstacles and impediments to cross-border transactions in the internal market already identified by the Commission in its first Communication on European contract law in 2003 are manifold and illustrate the **need for harmonisation of civil law**. This should be achieved by gradual full harmonisation of individual areas of law that have a particularly important bearing on cross-border business relations and result eventually in a common European civil-law regime. This probably long-term project could culminate one day in a **European Civil Code –** not just a special law governing cross-border activities, but a replacement for national codes which would avoid problems of demarcation and serve as a symbol of the European Union's common identity. Before entering into force with binding effect, the European Civil Code should be introduced in an intermediate step as optional law adopted voluntarily by the counterparties to cross-border transactions as their contractual basis (opt-in approach). Only once the Code has been tested in practice will it be clear whether it is appropriate and widely accepted.

The establishment of further Forum groups for retail products

The European Commission states in its Green Paper that it intends to set up further **Forum groups for specific retail products,** similar to the Mortgage Credit Forum Group. The Association of German Banks welcomes the establishment of further expert groups composed

of market participants but sees at the same time the danger that setting up product-related expert groups may trigger a tendency to harmonise products at the expense of market innovativeness. The aim should not be to draft new product-related rules but to identify and remove the legal provisions that currently obstruct the cross-border supply of products and services.

Codification and simplification of existing rules on information requirements

The European Commission's intention to simplify and codify the rules on information requirements, which differ according to the distribution channel used for products and services, is to be welcomed. However, to increase legal certainty in cross-border transactions, all civil-law provisions (e.g. instruction on right of cancellation) should be standardised EU-wide. This would remove the need for the current time-consuming and costly examination of every single national legal regime, which is an obstacle to the cross-border supply of products and services.

Comments on specific aspects of the debate on further measures concerning **bank accounts** are set out in **Annex 5**.

5. Need for further action

5.1 Reform of accounting standard setter

The adoption of the Regulation concerning the application of international accounting standards (IAS Regulation) marks an important step forward in the convergence of Europe's capital markets. The regulation requires listed European companies to prepare their consolidated accounts on the basis of IFRS from 2005. Germany's private banks warmly welcome mandatory application of IFRS since comparable and internationally accepted accounting standards are indispensable to the integration and efficiency of the capital markets. We share the Commission's view, however, that a critical look needs to be taken at both the **composition and funding of the international standard setter the IASB and the standard-setting process itself**. We fully support the Commission's activities in this regard, which aim at ensuring adequate consideration of European interests, compliance with due process and sustainable funding arrangements. The objective should be for European market realities to be taken into account right from the start of the standard-setting process. The emergence of "European IFRS" must be avoided at all costs. Efforts should therefore concentrate on obtaining greater European representation on the various bodies of the IASB. Establishing parallel European interpretation committees or similar groups would serve no useful purpose, in our view.

5.2 Further work on tax law harmonisation

Differences in tax arrangements are among the **most rigid remaining obstacles to a true single market for financial services**. This can be concluded both from the reports of the Commission's four high-level expert groups (on banking, insurance, securities and asset management)[3] and from the comments of market participants in the course of consultations to date. In consequence, any plan for the integration of Europe's financial services markets must include measures to ensure that cross-border competition is not hampered by tax obstacles. Such obstacles include rules on corporate taxation or tax on investment income that prevent or hinder banks or customers in one member state from offering or using products in another member state because non-residents receive less favourable tax treatment than do residents. Another example is when investments in another member state are impeded by barriers that do not exist at home.

The Association of German Banks therefore believes **it is regrettable that the Green Paper proposes no measures to improve the difficult tax environment** in which all market participants find themselves. This means it is ultimately left to the European Court of Justice to remove instances of tax discrimination ex post instead of finally tackling existing obstacles in the area of corporate taxation, the taxation of private capital income and VAT, for example.

Annex 6 outlines our views on the need for further action in these areas in more detail.

[3] See http://europa.eu.int/comm/internal_market/finances/actionplan/stocktaking_en.htm.

Annex 1: Better regulation for the financial services sector

An active government policy aimed at improving the quality of state regulation – which should automatically involve less bureaucracy – is indispensable both for the European Union and all of its member states. The excessive burden of state rules and regulations has assumed economically and financially damaging proportions. A survey by the World Bank shows that too much regulation leads to greater inefficiency in public-sector institutions, more unemployment, increased corruption and lower productivity. It is estimated that bureaucracy in the EU costs 340 billion euros. If we succeeded in reducing this bureaucratic burden on companies by just one quarter, calculations by the Dutch government show that real gross domestic product (GDP) in the EU could rise by 1.7%.

The task of improving the quality of regulation must be tackled by member states and the European Commission in tandem since almost half of all legislation in member states originates at EU level. Action by national governments alone will therefore not suffice especially in view of the fact that ongoing European integration will continue to increase the proportion of rules and regulations, and thus the burden of red tape, which is passed at European level to replace existing national laws.

The most important element of better regulation is consistent impact assessment. The aim should be to improve the quality of new measures with the focus firmly on boosting growth and freeing up the economy. This can only be achieved if legislators identify the various options open to them, carefully weigh up the pros and cons of their likely impact and subject them to a cost-benefit analysis. Legislative impact assessment is highly complex. It will only succeed in delivering better regulation if objectives are co-ordinated, the implementation of measures is monitored and remedial action is taken if a measure falls short of its objective. Central regulation management is therefore essential.

An impact assessment mechanism satisfying the following criteria should be set up at both EU and member state levels.

Management by a central regulation office

The OECD describes regulation management as a key element of an efficient regulation policy and a tool with which to monitor and promote compliance with the rules of good regulation in all government departments and at all government levels. The objective must be to co-ordinate action between individual departments with a view to establishing a sound set of rules. This objective can best be achieved if a central office is responsible for ensuring that regulation is of high quality. The EU should take note of the UK's positive experience with a central regulation authority. An office should be set up to monitor the impact assessment process and act as a co-ordinator between departments. The office could also be responsible for establishing binding regulation standards, developing uniform implementation procedures and providing legislators with practical support.

Regular reporting to this central regulation office

The impact assessment is carried out by the responsible authorities and departments. This is not a one-off process, but should monitor a new measure from its initial inception until the legislation is passed. Regular reporting to the central regulation office is therefore absolutely essential if the quality of the impact assessment is to be assured.

Independent monitoring and consultative body

In the countries where legislative impact assessment is already carried out, it has proved valuable to set up an independent monitoring and consultative body. The EU should learn from this experience and create an independent consultative body to support the regulation authority. The body should advise departments and the parliament on the most important legislative issues and document legislative activities. It should publish surveys and annual reports on the development of the impact assessment process and put forward concrete proposals for improving regulation.

Development of indicators to measure the quality of regulation

The quality of individual measures can only be measured by examining the associated costs and benefits. The Netherlands has had positive experience of estimating the approximate cost of a piece of legislation on the basis of the associated bureaucratic costs. The method developed there of measuring the bureaucratic costs incurred by companies, known as the "standard cost model", is now also recommended by the OECD. It could therefore doubtless play a useful role in establishing a legislative impact assessment system.

Transparency

Transparency is one of the cornerstones of efficient regulation. Achieving transparency is a challenging undertaking, however, which requires a number of prerequisites to be met. These include standard methods of drafting and amending legislation, consultation with affected parties, efficient communication and clear wording, disclosure and codification to facilitate accessibility, monitoring of administrative discretion, and effective implementation and legal redress procedures.

There is ground to be made up in the EU in addressing the issue of better regulation, both at national and at European level. Member states such as the UK and the Netherlands are pioneers in this area. When developing a national impact assessment system, the EU should draw on the experience already gained in these counties. The cornerstones of such a system should an effective consultation process, the creation of a central regulation office and independent consultative body, and standardised methods of measuring the associated costs.

Annex 2: The three-step evolutionary approach to supervising financial services

In principle, an evolutionary process is a suitable means of arriving at a European supervisory model that takes account of industry practices and minimises the regulatory burden for financial services firms. The **three-step approach** proposed by the Commission **is far too abstract and imprecise, however**. In particular, it fails to spell out what initiatives and measures the Commission is planning to introduce to achieve efficient and effective supervision. Nor does it set out a timetable from now until 2010. In its present form, the proposal provides no indication whatsoever of how the existing inefficiencies in European supervisory practices are to be remedied over the next five years. We therefore call on the Commission to put forward a coherent blueprint with a list of specific measures and implementation deadlines.

Step 1: Agreement on overall policy objectives

The objectives should be formulated more precisely and assigned corresponding measures together, as far as possible, with a timetable. It is unclear, for example, ***how*** and ***when*** "avoiding unnecessary duplication in regulation and supervision will reduce industry burdens and foster expansion of cross-border financial services".

We agree that national regulators should have the necessary and, we would like to add, preferably ***uniform*** **powers** at their disposal **to supervise and co-operate**. Nevertheless, we should like to stress that it is as yet an open question whether the banks' activities on European financial markets can and should "be subject to the same supervisory requirements both on a cross-border and ***cross-sectoral*** basis". This needs first to be examined and discussed in detail.

One of the Commission's stated policy objectives is to "*maintain* the highest, most up-to-date standards of regulation, oversight and supervision". Given the obvious inefficiencies of present standards, this is an unfortunate choice of phrase. A term such as "create" or "ensure" would be more suitable in our opinion.

Step 2: Maximise current framework, identify gaps and develop existing tools

The Association of German Banks disagrees with the Commission's assessment that more consolidated supervision is "a long-term objective". The financial services industry urgently needs **short- to medium-term measures** to come closer to the objective of one-stop supervision. As things stand, only the consolidated supervisor model envisaged in the Capital Requirements Directive (CRD) implementing Basel II has the potential to achieve greater legal and planning certainty under the existing system of national supervisory authorities. We therefore call on the Commission to take steps to extend the consolidated supervisor model to the implementation of Pillars II and III of the CRD and to other areas as well.

The Commission's view that "we should give the new supervisory committees a few years before they deliver their full potential" falls far short of what it has said on this issue in talks and unofficial statements up to now. It would be extremely disappointing if the Commission really intended to take concrete steps towards establishing a more integrated supervisory system only in a few years time. In particular, there is no indication in the Green Paper of the Commission's previous commitment to be rigorous in the coming years in eliminating the obstacles to consolidated supervision.

Step 3: Development of new structures

We welcome the European Commission's basic willingness to develop **new supervisory structures**. We are convinced that there is ample evidence to show that the present framework will be unable to fulfil the overarching objective of **adapting supervisory structures to reflect the way in which internationally active financial services firms now operate**.

The absolute limitations of a system of co-operating supervisory authorities are clear. It will at best be possible to move in the direction of consistent and competitively neutral supervisory practices under such an arrangement. This is why it is important to start thinking right away about the next steps and identify their (legal) prerequisites and consequences in detail. We therefore call on the Commission to take a critical look at what has been achieved so far in the evolutionary process and press resolutely ahead with the necessary structural and legal changes.

The Association of German Banks calls for agreement in the short term on a **lead supervisor system** to be responsible for the consolidated supervision of cross-border financial groups. In our view, developments should ultimately lead to a **European System of Financial Services Authorities (ESFSA)** with a supranational agency at its head modelled along the lines of the European System of Central Banks[4].

[4] See also the Association of German Banks position paper "Institutional development of European Supervision" (March 2005) at http://www.bankenverband.de/pic/artikelpic/022005/Stn-2005-01-28-Thesenpapier_Himalaya-Report-engl.pdf.

Annex 3: Barriers to cross-border mergers and acquisitions

Ban on acquiring qualified participations under Article 16 of the Banking Directive

Article 16 of the Banking Directive (2000/12/EC) requires the competent authorities to be notified of any plans to acquire a qualified holding in a credit institution, exceed a participation threshold of 20, 33 or 50%, or turn the institution into a subsidiary.

Supervisory authorities are then able to prevent the plan from going ahead if they are not convinced of the acquirer's suitability to ensure sound and prudent management of the bank. Since the possibility cannot be excluded that Article 16 may sometimes be used for protecttionist purposes, the European Commission has put forward proposals for a possible modification of the Article.

Even if consolidation in the European banking industry lags behind that in other sectors, the Association of German Banks does not believe that Article 16 is a major explanation. And given that **Article 16 plays a key role in safeguarding the integrity of the financial system**, any amendments should be very carefully considered and analysed in advance.

If it is felt necessary to specify in more detail the criteria to be applied when reviewing qualifying shareholdings, these should be consistent with national law. Moreover, it should be borne in mind that a blanket clause is often better able to take account of the diversity of potential circumstances than are highly detailed rules.

In any event, it might make good sense to add a provision to Article 16 explicitly stipulating that it serves prudential purposes only and may not be applied for national considerations or focus on the country of origin of the acquirer.

The addition of transparency provisions would also be very welcome. This would be in line with the principle of supervisory disclosure currently envisaged in the directive implementing Basel II in the EU. In particular, it would most certainly have a positive effect if competent authorities were required to provide the parties concerned with detailed reasons for a negative decision.

Public ownership of significant sections of the banking industry

The public ownership of large sections of the German banking industry, the **legal restriction of the use of the name "Sparkasse"** to German public savings banks and the **"regional principle"**, which largely excludes competition within the savings bank and co-operative sectors, are extremely serious obstacles to consolidation in the European financial services industry. The Savings Banks Acts of the German Länder stipulate that Landesbanken and Sparkassen must be publicly owned, thus totally excluding a significant section of the German banking industry from mergers with, or acquisitions by, foreign banks. There can be no

question of any misapplication of Article 16 by supervisors where these banks are concerned, since cross-border consolidation is ruled out from the outset.

This ownership structure, which does not exist in this form in any other member state, including the eastern European accession countries, is a far greater obstacle to the development of the European financial services industry than is Article 16. Germany's Savings Banks Acts should therefore be amended to allow all investors, foreign or otherwise, the same rights to acquire holdings in all German banks.

The **principle of reciprocity** will be violated as long as this is not the case because German public-sector banks can, in contrast, already acquire private foreign banks and have on occasion already done so. It will also be necessary to lift Section 40 of the German Banking Act, which restricts use of the name "Sparkasse" to public-sector banks. Only if an acquirer is allowed to continue operating a bank under the name with which it has become established on the market will any real investor interest – a prerequisite for consolidation – be able to develop. Moreover, the regional principle needs to be abolished, as it would prevent an acquirer from expanding in line with its business strategy.

Insufficient harmonisation of the supervisory framework

The current draft of the directive implementing Basel II in the EU contains a **large number of national options** which may be exercised differently in each member state. It is also perfectly conceivable that qualitative supervisory rules – even if they apply uniformly throughout the EU – will be interpreted and implemented in differing ways by national competent authorities.

If a cross-border merger takes place, this means that the part of the company which is not located in the future home country of the merged entity will have to adapt its business processes and structures to a new supervisory regime in all areas where there are differences in the way an option is exercised or a qualitative rule interpreted. These one-off adjustments can be extremely costly and make a potential merger seem less attractive.

There are even more serious problems when it comes to cross-border takeovers and group structures. The subsidiaries and parent company continue to be supervised by different authorities, giving rise to an onerous requirement to file solvency reports based on different supervisory rules. This in turn will necessitate different IT systems and business processes. In risk management, the associated costs can sometimes be prohibitive.

Excessive and non-harmonised consumer protection rules

A serious economic obstacle to cross-border mergers and acquisitions are the generally excessive and nationally varying **civil-law rules to protect retail banking customers** (information requirements, instruction on right of cancellation). They hinder cross-border

expansion because they make costly and time-consuming examinations of different national legal regimes necessary and business processes cannot be harmonised company- or group-wide.

Another problem is the general lack of harmonisation in civil law and contract law. The differences between substantive-law aspects of national civil-law regimes mean that, where banks operate across borders, business processes cannot be standardised in many cases but have to be adapted to take account of national particularities. As a result, economies of scale and fixed-cost savings cannot be achieved to a large extent. The different civil-law regimes not only make the conclusion of contracts much more complicated, they also greatly increase the cost of enforcing claims arising from cross-border contracts.

Company-law issues

The supra-national legal form of the European Company (Societas Europea – SE), which has been available since the end of 2004, facilitates cross-border restructuring and co-operation for companies; in particular, the SE enables companies to merge across borders and to transfer their seat in a manner allowing them to retain their identity. Cross-border mergers independent of the SE are not possible at present, however. For example, the **German Companies Re-registration Act**, which is based on the "real seat doctrine", does not permit cross-border mergers and merely governs changes in the legal form of companies based in Germany.

The proposal for a directive on mergers of companies from different member states (10th Company Law Directive – European Mergers Directive) is thus a step in the right direction. However, there is still room for improvement in the Mergers Directive too. While the political agreement on the controversial issue of German employee participation reached in the European Council on 25 November 2004 must in principle be welcomed, it is not sufficient to prevent the existing discrimination of German companies.

Tax issues

The tax treatment of hidden reserves in cross-border mergers is not regulated satisfactorily at present by European legislators. Under current Community law, there is the danger that the disclosure of hidden reserves may result in **double taxation** in both countries concerned. This increases the tax burden for cross-border companies and creates a degree of legal uncertainty that seriously hinders an economic assessment of potential mergers with a cross-border dimension.

Whilst the treatment of hidden reserves only concerns mergers and thus a once-only operation, the current **taxation of earnings** raises **permanent obstacles** to cross-border groups and thus to corporate takeovers. European tax law should therefore be amended so that **loss**

offsetting for tax purposes between parent companies and subsidiaries is allowed in future across borders as well.

Obstacles still existing after the Taxation of Mergers Directive (2005/19/EC)

The tax treatment of hidden reserves in cross-border mergers is still not regulated satisfactorily even after Directive 2005/19/EC of 17 February 2005 amending the (Taxation of Mergers) 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 accompanying uncertainty about tax understandings (execution risk) greatly hinders an economic assessment of potential cross-border transactions. Major concerns, such as the abolition of double taxation of hidden reserves as the "price" for automatic tax deferral on the transaction date and the treatment of partnerships, have still not been settled. Moreover, the rules in the amended Taxation of Mergers Directive raise questions concerning their compatibility with basic freedoms in regard to tax law, particularly the permanent establishment clause, the exemption of third-country permanent establishments and the acceptance of double taxation (once-only cost risk).

This is made clear particularly by the fact that the directive allows final taxation of non-realised profits by an EU member state through disclosure of hidden reserves even if the economic assets concerned are merely transferred at company level to another permanent establishment or the head office in another EU member state or the shareholder merely moves to another EU member state.

Obstacles to current taxation of earnings

Besides the need for modification of the Taxation of Mergers Directive, which concerns a once-only operation, current taxation of earnings raises permanent obstacles to companies which invest within the EU in more than one country (continuous costs).

A hindrance are

- tax questions in connection with transfer pricing,
- the absence of a homogeneous system of loss offsetting in the EU, where relief is urgently needed by extending loss offsetting for tax purposes within a group to cover losses made by subsidiaries and permanent establishments in other EU member countries, regardless of national sovereignty in taxation of correlated profits[5] or by introducing the concept of the common consolidated corporation tax assessment basis.

[5] See closing address of Advocate General Maduro in the ECJ Proceedings - Marks & Spencer v David Halsey (Case 446/03).

VAT obstacles

Underlying most mergers and acquisitions is the ability to benefit from cost saving by centralisation of services. Unfortunately, it is very often not possible to make savings because cost reductions are negated by substantial additional VAT costs as the financial services industry suffers from a lack of VAT neutrality.

One of the main obstacles, and in a number of cases the fatal obstacle, for pan-European integration is created by the outdated VAT treatment of the financial services industry and the uncertainties surrounding this treatment. These obstacles are essentially caused by:

- lack of EU-wide agreed definitions of financial services and products;
- lack of a clear delineation between exempt and taxable financial services;
- lack of clear delineation between exempt financial services and taxable physical or administrative services;
- outdated rules that do not provide any guidance with regard to the VAT treatment of new financial products such as derivatives;
- lack of possibility to create VAT grouping in all member states so that VAT s not chargeable, especially the fact that cross-border VAT grouping is not allowed;
- inconsistent implementation of the exemption of cost-sharing associations which allows members to share the costs of a shared service centre without incurring VAT – although the implementation of this provision is not optional for member states;
- increasing number of member states seeking to claim VAT on branch-to-branch or head office-to-branch structures although transactions within the same legal entity do not trigger any VAT.

A major obstacle regarding the VAT treatment of transfer of a financial business is also the inconsistent definition and application of the “non-supply rule”, which enables member states to facilitate transfers of (parts of) undertakings by simplifying them and preventing burdening the resources of the transferee with a disproportionate VAT charge. This rule is of critical importance for financial institutions, most of which have no or only a limited right to recover input VAT. Although most member states have implemented this provision, the absence of a uniform interpretation becomes particularly burdensome when member states of transferor and transferee apply different rules causing them to come to different conclusions.

Annex 4: Regulatory dialogues with specific third countries

Dialogue with EU accession candidates and neighbouring countries

The private banks in Germany welcome the Commission's commitment to carefully monitor **candidate countries**' fulfilment of their responsibilities in the financial services area. Candidate countries should have the acquis communautaire for financial services in place as early as possible, so we clearly support the Commission's pro-active approach on this issue. Transition periods, let alone permanent exemptions, would distort competition in the enlarged EU single market for financial services and should thus not be tolerated. We would also support the suggested transfer of EU rule principles to the partner countries of the **European Neighbourhood Policy** as applicable.

Dialogue with the US

We agree with the description of the **EU-US financial markets regulatory dialogue** in Annex I, Section V, of the Green Paper. As recent history shows, uncoordinated legislation, regulation and supervision of financial markets in the EU and the US create regulatory spillovers that bring about duplicate and contradictory requirements for internationally active banks. The dialogue should be deepened further to avoid such problems ex-ante. We welcome the growing awareness by lawmakers and regulators on both side of the Atlantic that the equivalence of financial market standards – whether prudential, capital market or anti-money laundering – needs to be recognised at an early stage of the rule-making process and that this sometimes requires working on the convergence of such standards. The EU and the US could take a big step forward strategically if they were to actively seek greater mutual recognition of their regulatory frameworks for banking and capital markets (equivalence), though this may inevitably involve some adjustment of both sides' rules and standards (convergence).

The Green Paper is correct in highlighting the importance of the **equivalence and mutual recognition of IFRS and US GAAP**. Recognition of IFRS by the US securities regulator, the SEC, is key to the global acceptance and comparability of accounting standards. We believe the roadmap for mutual recognition recently agreed between the European Commission and the SEC is a major step in the right direction. It will be important to make sure, however, that the SEC's conditions for recognising IFRS are not used as a pretext for refusing or delaying the recognition of IFRS in the US. In our view, it is vital to achieve mutual recognition by 2007 since this is when the transitional arrangements of the IAS Regulation come to an end. Should the SEC not have recognised IFRS by then, European companies with a US listing would go on having to prepare two sets of accounts or reconcile to US GAAP. We believe it would be desirable for the SEC to recognise IFRS and the Commission to recognise US GAAP simultaneously.

Implementation of Basel II is also rightly included in the list of major themes for the EU-US regulatory dialogue. US host and EU home-country supervisors of European banks should apply Basel II in a way that minimises double regulation of US financial holding companies, US banking subsidiaries and US branches of European banks. Prudential recognition of internal rating systems should be a focal point of the co-ordination between supervisory authorities across the Atlantic. Strongly diverging rules would not only duplicate costs but, taken to the extreme, require banks to introduce duplicate rating systems at group and solo levels. This would run counter to the aim of establishing risk monitoring and management at group level. The importance of this aspect has been taken into account in the EU implementation of Basel II by giving the home-country supervisory authority the right to make the final decision on recognising the rating systems of the entire banking group (within the EU). It would desirable to have a comparable rule in the transatlantic context.

We believe the following should be added to the list of priorities for the dialogue:

- Achieving an understanding with the US on that would give **European banks legal protection against applications of Section 319a USA PATRIOT Act.** Currently, this extraterritorial legal risk is of particular concern for European banks with business ties to countries and persons that are sanctioned by the US but not by the EU (Cuba, Iran, Commercial Bank of Syria).
- Abolishing the SEC host-country consolidated supervisory requirements for European banks with US broker/dealers that qualify for the SEC's alternate capital requirements.
- Reforming further the US asset pledge and capital equivalency deposit requirements by the New York State Banking Department and US Congress respectively.

Institutionally, we welcome the intention to **involve the private sector** on an informal basis and offer to co-ordinate our member banks' input, also in the framework of the EBF. We understand that member states' involvement in the dialogue will continue to **include their supervisory authorities, in particular within CEBS and CESR**.

Dialogue with Switzerland, Japan, China und India

The existing regulatory dialogue with **Switzerland** and **Japan** could be deepened along the same lines. As to **China**, the discriminatory and restrictive treatment of local branches of European banks in this market calls for urgent action. We wonder whether the Green Paper's assessment in Section 3.4 of the regulatory dialogue with China is not far too positive when measured against the more realistic description in Section V of Annex I. We would welcome very much indeed the Commission swiftly addressing these problems in the new regulatory dialogue with China as well as via the financial services negotiations in the Doha Round of the WTO.

Where the above-mentioned major countries have discriminatory or prohibitive regulation of European banks in place, the **EU regulatory dialogue and EU trade policy should be co-ordinated to maximise results**. The same goes for India, and perhaps Russia, too, although the problems there are not as dramatic as in China. **In the framework of the WTO negotiations and in its bilateral trade policy, the EU should also address other emerging market countries** which still have discriminatory or prohibitive restrictions in place on legal forms of establishment for European banks and their operation or have not yet guaranteed their more liberal regimes in international trade agreements.

Annex 5: Specific issues connected with the regulation of bank accounts

To allow “European bank customers” easier cross-border access to retail products, the following measures should be implemented particularly in the field of electronic distribution in the short or medium term:

- The possibility to open **accounts** (across borders) via the Internet, i.e. as part of online banking, would make things much easier for consumers and banks. At present, the customer identification procedure required in this connection differs – widely, in some cases – from country to country, causing a clear break in the system at any rate. In Germany, for instance, the “PostIdent” procedure is used to open an account with an online bank. After downloading the bank’s account-opening forms from the Internet and printing these out, the customer has to have his signature verified by an employee at a branch of Deutsche Post AG and then post it to the bank. This time-consuming and costly procedure could be avoided if the European Commission were to create a legal basis expressly allowing accounts to be opened EU-wide with a qualified electronic signature. An electronic signature can adequately ensure the required authenticity, integrity and evidential certainty of electronic declarations of intent made by the counterparties to electronic transactions. For this purpose, harmonisation of existing national provisions with those of the Electronic Signatures Directive is needed. For Germany, this would mean bringing the identification requirements in the Money Laundering Act and the Tax Code into line with the requirements in the Electronic Signatures Directive.
- A further advantage of **identification by means of an electronic signature** would be that the “identity theft” problem existing in some countries could be permanently eliminated. This problem is caused by, among other things, relatively lax national identity check requirements that allow customers to open an account by presenting an electricity or gas bill, for example.
- In **lending business**, neither guarantee agreements nor consumer credit contracts may be concluded at present via the Internet in many member states – the “electronic form” cannot be used in Germany, for example (see Section 492 (1) sentence 2 Civil Code). It is unacceptable that consumer credit contracts cannot be concluded online: The cooling-off period provided in the Distance Selling of Financial Services Directive gives consumers enough time to cancel if necessary. Furthermore, under German law consumers are granted the right to cancel credit contracts “irrespective of the medium used” (see Section 495 Civil Code). Legislators are called upon to lift this restriction on online banking across the EU as soon as possible.

Not an obstacle on the way to a single European financial market is the need for improved portability and easier closure of accounts mentioned by the European Commission. Under German law, consumers can already close an account today without any trouble and, when transferring their account, are helped by the so-called “removal service” provided by their new bank.

Annex 6: Further tax regulation needed

The financial markets are affected not only by the tax treatment of the issues mentioned (cross-border mergers and acquisitions in the EU banking sector (see section 3.3) and clearing and settlement (see section 3.1)) but, above all, by the application of VAT and company tax law as a whole (corporation tax, taxation of re-registered companies).

The aim must therefore be to achieve greater legal certainty Europe-wide and remove tax obstacles. This means, specifically,

- ensuring **VAT neutrality** for the financial industry
- harmonising **profit determination for companies** which invest in more than one EU member state
- extending **loss offsetting for tax purposes** within a group to subsidiaries and permanent establishments in other EU member states and
- settling important issues which the **European Savings Tax Directive** leaves open.

VAT treatment of financial services

The overall objective of the Commission's financial services policy is to consolidate the progress towards an integrated, open, competitive, and economically efficient European financial market and to remove the remaining economic barriers. Therefore the Green Paper has to identify **VAT issues as major obstacles to integrated markets**. Today, the current VAT system for financial services prevents efficient implementation of a single European market.

The financial industry suffers from a lack of VAT neutrality as most financial services are tax-exempt and so generally do not allow for input tax deduction. VAT thus becomes an irrecoverable cost. This **"hidden VAT"** often undermines the development of efficient and economically sound business structures which are necessary for European financial groups to maintain a competitive position in global financial markets. Besides the non-neutrality issues, there are concerns in terms of legal certainty since there is no clear definition of financial services. The **list of tax-exempt financial services in the 6th VAT Directive is too narrow** and no longer reflects today's realities.

If European financial groups are to remain competitive in the face of increasing internationalisation and globalisation in the financial markets, they need to adopt structures which would enable them to realise cost savings without creating additional VAT burdens that always neutralise the benefits of the synergies generated by these structures. Therefore it is essential to ensure the neutrality of VAT for the financial industry, especially regarding intra-group transactions. To ensure greater legal certainty, the 6th VAT Directive has to be adapted to today's

realities and it must be ensured that the Directive's rules are implemented consistently in national law in all member states.

Therefore the priorities identified in the Green Paper – especially **simplifying and consolidating all relevant (European and national) financial services rules**, working with member states to improve transposition and to ensure consistent implementation, evaluation of whether the existing directives and regulations are delivering the expected economic benefits and repealing measures that do not pass this test – are of the utmost importance with regard to VAT on financial services as well.

That is why the Green Paper has to identify today's VAT system as a formidable obstacle to cross-border transactions in integrated financial markets and future European financial policy has to work on eliminating or at least reducing these unjustified VAT barriers in order to strengthen the competitiveness of the financial sector and the economy as a whole.

Corporate taxation

In the field of corporate taxation, we welcome it that the European Commission aims to harmonise profit determination for companies which invest in more than one EU member state, create pan-European rules for a **common corporation tax assessment basis** and enable companies to offset (and consolidate) profits and losses at overall EU level.

For the concept of a common consolidated corporation tax assessment basis to be a success, we believe that

- other company-related taxes on earnings, provided these are levied in individual member states, should also be included,
- the still open questions of
  - the profit allocation formula and its factors
  - consolidation and elimination of inter-group profits and
  - the applicable profit-determination rules should be settled, while
- the hitherto ignored double taxation problems in the global context of the growing internalisation of business, i.e. in relation to third countries, must be resolved.

Irrespective of whether the concept will be successful, extension of loss offsetting for tax purposes within a group to cover losses made by subsidiaries and permanent establishments in other EU member countries must be called for, regardless of national sovereignty in taxation of correlated profits (see closing address of Advocate General Maduro in the European Court of Justice Proceedings - Marks & Spencer v David Halsey (Case 446/03).

Taxation of private capital income

While acknowledging the results achieved by the **European Savings Tax Directive**, it should be noted that the directive leaves important issues unsettled:

As the directive does not seek substantive tax harmonisation and adopts a **definition of interest** that differs from that in many member states, certain income from investment certificates and innovative financial products is, in particular, excluded from its scope, with its exclusion being largely a matter for national interpretation at present.

The legal uncertainty associated with the different national taxation is an obstacle to cross-border offers of these products. It is therefore already clear that the European Savings Tax Directive, which has just entered into force, needs to be reviewed in these areas. What is required is harmonisation of the substantive tax provisions, particularly the definition of interest and the assessment bases.