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Governance, Regulation & Compliance

Regulatory Radar

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Newsletter on banking and financial regulation

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This month's Regulatory Radar includes the following interesting publications in the area of the Financial Services Industry in general:

- The publication of the Regulation (EU) No 513/2011 putting in place the new supervisory architecture for credit rating agencies;
- The Basel Committee's report on the Range of Methodologies for Risk and Performance Alignment of Remuneration which is intended to enhance banks' and supervisors' understanding of risk-adjusted remuneration.

In relation to Credit Institutions and Investment Firms, amongst others, an interesting ECB working paper was published "The bank lending channel: lessons from the crisis" which looks at the impact of banks' conditions on the provision of credit and the transmission mechanism of monetary policy during the recent crisis via a sample comprising more than 1,000 listed banks from 15 countries.

In the area of Investment Products and Asset Management, IOSCO published its Principles for Dark Liquidity aiming to assist securities markets authorities in dealing with issues concerning dark liquidity.

Interesting papers on Solvency II have been published in May, e.g. the summary of the responses to the EC consultation on the Solvency level II implementing measures. The summary shows that stakeholders' concerns relate to a small number of key issues, namely the impact on long-term products, volatility and pro-cyclicality, proportionality and limiting the reporting burden and the need for transitional measures in certain areas.

In the tax area, the Belgian Law of 14 April 2011 containing miscellaneous provisions was published in the Official Journal of 6 May 2011. This law contains a chapter modifying various tax provisions, mainly to bring them to compliance with European law. A number of modifications related to e.g. deduction of interest expenses, dividend received deduction and notional interest deduction, are relevant for the financial sector.

We hope you enjoy the reading.

The Editorial Board.

Financial Services Industry

Normative documents

Official Journal of the European Union (OJ)

AML/CFT and sanctions

In May, the following documents related to AML/CTF and sanctions measures were published in the Official Journal:

- Council Regulation (EU) No 442/2011 of 9 May 2011 concerning restrictive measures in view of the situation in Syria and Council Decision 2011/273/CFSP of 9 May 2011 concerning restrictive measures against Syria in OJ L 121 of 10 May
- Commission Implementing Regulation (EU) No 480/2011 of 18 May 2011 amending for the 148th time Council Regulation (EC) No 881/2002 imposing certain specific restrictive measures directed against certain persons and entities associated with Usama bin Laden, the Al-Qaida network and the Taliban in OJ L 132 of 19 May
- Council Implementing Regulation (EU) No 502/2011 of 23 May 2011 implementing Regulation (EU) No 204/2011 concerning restrictive measures in view of the situation in Libya in OJ L 136 of 24 May
- Council Implementing Regulation (EU) No 503/2011 of 23 May 2011 implementing Regulation (EU) No 961/2010 on restrictive measures against Iran in OJ L 136 of 24 May
- Council Implementing Regulation (EU) No 504/2011 of 23 May 2011 implementing Regulation (EU) No 442/2011 concerning restrictive measures in view of the situation in Syria in OJ L 136 of 24 May
- Council Implementing Regulation (EU) No 505/2011 of 23 May 2011 implementing Regulation (EC) No 765/2006 concerning restrictive measures against President Lukashenko and certain officials of Belarus in OJ L 136 of 24 May
- Council Decision 2011/299/CFSP of 23 May 2011 amending Decision 2010/413/CFSP concerning restrictive measures against Iran in OJ L 136 of 24 May
- Council Implementing Decision 2011/300/CFSP of 23 May 2011 implementing Decision 2011/137/CFSP concerning restrictive measures in view of the situation in Libya in OJ L 136 of 24 May
- Council Implementing Decision 2011/301/CFSP of

23 May 2011 implementing Decision 2010/639/CFSP concerning restrictive measures against certain officials of Belarus in OJ L 136 of 24 May
- ➲ Council Implementing Decision 2011/302/CFSP of 23 May 2011 implementing Decision 2011/273/CFSP concerning restrictive measures against Syria in OJ L 136 of 24 May

Credit ratings Agencies

On 31 May, the ➲Regulation (EU) No 513/2011 of the European Parliament and of the Council of 11 May 2011 amending Regulation (EC) No 1060/2009 on credit rating agencies was published in OJ L145. The regulation puts in place a new supervisory architecture for credit rating agencies. Within the new architecture, the European Securities and Markets Authority (ESMA) is responsible for the registration and ongoing supervision of credit rating agencies in the European Union. Additionally, the regulator is tasked with drafting regulatory technical standards concerning the information to be provided by a credit rating agency in its application for registration, the information that a credit rating agency must provide for the application for certification and for an assessment of its systemic importance to the financial stability or integrity of financial markets, the presentation of the information, the assessment of compliance of credit rating methodologies with the requirements set out in Regulation (EC) No 1060/2009, and the content and format of ratings data periodic reporting to be requested from a credit rating agency for the purpose of ongoing supervision. In order to exercise its supervisory powers effectively, ESMA has been given the authority to conduct investigations, on- site inspections and impose supervisory measures and fines. The Regulation came into force on 1 June.

Financial Services and Markets Authorities (FSMA)[1]

Approval of market rules

In a press release (in ➲Dutch and in ➲French) of 13 May, the FSMA announced that it has approved the modified market rules of the regulated markets organized by Euronext NV/SA (namely "Euronext Brussels" and "the Euronext Brussels Derivative Instruments Market"). The new rules went into effect on 16 May.

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[1] As of 1 April 2011, the new "Twin Peaks" supervisory architecture has come into force in Belgium. The new architecture replaces the Banking, Finance and Insurance Commission (CBFA) with two new regulators, the National Bank of Belgium (NBB) and the newly created Financial Services and Markets Authority (FSMA). Within the new framework FSMA is responsible for the supervision of the financial markets and the "conduct of business" rules, the micro-prudential supervision of portfolio management and investment advice companies, UCI management companies and UCI's, institutions for occupational pension, financial intermediaries, the financial education of investors and their protection against the illicit provision of financial products and services.

Basel Committee on Banking Supervision (BCBS)

Remuneration

On 17 May, the Basel Committee published its ➲report on the Range of Methodologies for Risk and Performance Alignment of Remuneration. The report is intended to enhance banks' and supervisors' understanding of risk-adjusted remuneration. By providing clarification on the design of risk-adjusted remuneration schemes, the Committee aims to promote greater adoption of sound compensation practices in the banking sector. The report looks at various factors banks should take into account to incorporate risk and performance into bonus pools and individual compensation. It discusses the methodologies that promote sound incentives and which are used to adjust remuneration ex ante (e.g. through appropriate indicators and measures) or ex post (e.g. deferred compensation or clawbacks). Furthermore the report focuses on practical and technical issues that may reduce the effectiveness of the risk adjustment process. These include a lack of integration of remuneration processes into a bank's overall risk management framework, the use of performance measures that do not fully capture risks or the use of adjustments not sufficiently tailored to employees' seniority and activity.

Council of the European Union

Powers of ESMA and EIOPA

On 17 May, the Council of the European Union published the ➲Opinion of the European Central Bank on the Proposal for a Directive of the European Parliament and of the Council amending Directives 2003/71/EC and 2009/138/EC in respect of the powers of the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority. The opinion assesses the proposed directive from a financial stability perspective. The observations and drafting proposals contained in this opinion focus on aspects relevant to supervisory architecture reform, the involvement of the ECB, ESCB and of the ESRB and cooperation and information-sharing arrangements with the ESAs and national competent authorities. It also pays particular attention to the need to ensure where relevant consistent approaches across financial services sectors with a view to ensuring a level playing field and as a tool for supervisory convergence.

European Banking Federation (EBF)

Systemic risk

On 2 May, the EBF published a ➲position paper on systemic risk. In the paper, the Federation expressed its commitment to collaborate with policy makers in the development of solutions with a view to prevent a new surge of financial instability and to mitigate the build-up of systemic risk across the financial sector. According to

the EBF every market participant contributes to systemic risk as demonstrated during the recent crisis. Therefore, efforts should be led to the identification of sources and processes of systemic risk. The Federation indicated that the current policy developments are taking the direction of a multi-factor mechanical approach to measure the degree of systemic risk involved in a bank making use of accounting and statistical data readily available. Authorities should carefully assess the effectiveness and quality of the chosen proxies to ensure that unintended consequences are avoided before implementing additional capital and other requirements on banks. Moreover, the EBF indicated that they would see merit in exploring a wider range of measures and tools, since systemic risk and financial instability cannot be captured by a single set of indicators. However the use of lists of Systemically Important Financial Institutions (SIFI) or a capital surcharge approach is not the right solution to address the root problems. Conversely, the EBF stated that a continuous approach to systemic risk, in which all institutions as part of the network are deemed systemic to varying degrees, would be preferable. According to the Federation, the recent crisis has shown how weaknesses in risk management and business models can make an instrument, previously thought to be benign, spark off a general turmoil. Therefore, there is need for a dynamic monitoring mechanism in order to better anticipate where the next systemic risk accumulation is building up. For this purpose, dynamic macro-prudential surveillance is the cornerstone of systemic risk identification. Its indications should then be incorporated in the supervisory review and evaluation process conducted by micro-prudential supervisors. The Basel Accord provides a suitable framework to do so within the scope of the second pillar. Additionally, the defense against systemic instability should be armed around the crisis management framework in a three-staged approach, starting with a vigilance process of macro-prudential monitoring coupled with the closer oversight by the consolidating supervisors. An early intervention phase would trigger mechanisms aimed to maintain institutions as a going concern. The resolution authority would ensure that shareholders bear any losses incurred and creditors, if necessary, as a last resort will also be required to participate to some extent. Finally, the EBF stated that prudential actions should be based on sound examination of the origins of systemic risk and be led by a continuous monitoring and identification process.

European Central Bank (ECB)

Annual report

In May, the ECB published its ➲annual report for 2010. The report provides among other things an overview of the economic developments and monetary policy decisions, central bank operations and activities and the measures taken to improve the financial stability and integration in 2010 such as the Basel III package, the development of an integrated framework to reduce the risks and externalities associated with systemically important financial institutions, the reform of the

framework for crisis prevention, management and resolution and the establishment of the European Systemic Risk Board (ESRB).

SEPA

In a ➲press release of 13 May, the European Central Bank (ECB) and the Oesterreichische Nationalbank (OeNB) called on the financial services sector to speed up the implementation of the Single Euro Payments Area (SEPA). The ECB stressed that given the slower than expected migration towards the new pan-European payment instruments – the SEPA credit transfer (SCT) and the SEPA direct debit (SDD) – joint action and increased effort is needed to finalize the transition. Concrete deadlines for this migration should be put in place, i.e. the end of January 2013 for credit transfers and the end of January 2014 for direct debits. It also reiterated that retail payment solutions offered throughout SEPA must be easy to use and efficient, but also secure. Responsibility for the security of retail payments is shared by regulators, payment service providers, retailers and consumers. To reduce the possibility of fraud, the Eurosystem recommends that, within SEPA, payment cards are issued with only a chip and not with a magnetic stripe, since the latter is an easy target for fraudsters. Finally, the ECB recalled the need for at least one additional European card scheme, which offers its service in competition with already existing international cards schemes.

European Securities and Markets Authority (ESMA)[2]

Credit ratings Agencies

On 26 May, ESMA launched two calls for evidence in the area of Credit Ratings Agencies. The ➲first call concerned the ratings data periodic reporting requirements for CRAs according to Article 21 (3)(e) of the (Draft) Amended CRA Regulation. This call aimed to collect data and information for a preliminary assessment of the ratings data periodic reporting from Credit Ratings Agencies (CRAs), and other interested parties. In the call ESMA indicated that it is considering two different options regarding the content and format of the ratings data that registered or certified CRAs will have to send on a monthly basis. These are analytical data concerning specific rating actions or aggregated data regarding ratings. The gathered evidence will be considered in the preparation of a public consultation paper which will form the basis for drafting regulatory technical standards (RTS) on the subject concerned.

The ➲second call aimed to gather information from CRAs and other interested parties in preparation of a public consultation on the RTS on the assessment of compliance of credit rating methodologies with the requirements set out in Article 8(3) of the (Draft) Amended CRA Regulation. This article stipulates that credit rating agencies must use rating methodologies that are rigorous, systematic, continuous and subject to validation

based on historical experience, including back-testing.

Responses to both calls of evidence could be submitted until 20 June.

On 18 May, ESMA issued its ➲Guidelines on endorsement. The Guidelines address how ESMA will implement the "as stringent as" test for credit ratings produced outside the European Union, in what are named "third countries". The test requires that the credit rating activities performed by Credit Rating Agencies (CRAs) outside the European Union are subject to requirements established by law which are "as stringent as" those applicable in the EU. In the guidelines ESMA indicates that it will be flexible in assessing the requirements applicable in the third country. The wording of the provisions will not need to be identical to those set out in the EU Regulation. Furthermore it stated that it will take a global and holistic view in assessing to what extent the third country legal framework achieves similar adequate regulatory effects and meets the same objectives as the EU Regulation. In addition to the aforementioned, the guidelines also clarify that EU CRAs can continue to issue credit ratings produced outside the EU after the 6 June at least until the point of registration. If at the point of a CRA's registration, credit ratings issued outside the EU are not considered endorsable in the European Union, because an appropriate regulatory regime has not entered into force in the relevant third country (or the other necessary conditions as set out in the Regulation are not in place), the use of such credit ratings for regulatory purposes by financial institutions will still be possible for three months from that date. ESMA will assess whether the use of such credit ratings can continue for another three month period, in order to avoid the potential for market disruption or financial instability. This would be communicated to the market as soon as the decision is taken.

On 17 May, ESMA published ➲its technical advice to the European Commission on fees for Credit Rating Agencies (CRA's). The advice will be used by the Commission to draft a Regulation on the subject. With regard to on-going supervisory fees of registered CRAs, ESMA suggests in its advice that a single periodic fee based on the total turnover of the CRA relative to the total turnover of all CRAs registered in the EU should be used. The basis for calculation would be total turnover (including rating and non-rating activities) published in the audited accounts. The payment of the annual fees would be divided into two installments, the first one should be payable by the end of February, the second one, by the end of September. For registration fees to be charged to applicant CRAs, ESMA proposes different registration flat fee bands based on objective criteria for assessing the complexity of the application. The concrete amounts charged to CRAs would depend on the number of employees of the applicant (as a proxy for the expected turnover). Finally, for the fees with respect to certification, ESMA suggest a flat fee for both applications for certification and the supervision of certified CRAs.

[2] ESMA has replaced the Committee of European Securities Regulators (CESR), as of 1 January 2011.

Financial Stability Board (FSB)

Compensation Practices

In a ➲press release of 18 May, the FSB announced the launch of its second peer review on compensation practices. The review will assess the progress made by national authorities and significant financial institutions in implementing the FSB ➲Principles for Sound Compensation Practices and ➲their Implementation Standards, as well as the impact on compensation practices at financial institutions of national policy measures taken to implement the Principles and Standards. It will look at the different approaches to implementing the FSB Principles and Standards by surveying supervisors and regulators and by surveying a sample of major firms directly. The responses of supervisors and regulators, and aggregated responses of firms will be analyzed and discussed by the FSB later this year. The peer review report will be published in the autumn.

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Credit institutions and investment firms

Consultative or informative documents

Bank of International Settlements (BIS)

Basel III and global liquidity

On 26 May, the BIS published ➲the speech its General Manager, Mr. Jaime Caruana, gave at the International Capital Markets Association Annual General Meeting and Annual Conference the same day. In the speech, Mr. Caruana suggested that bankers, bond underwriters and investors, as gatekeepers of credit, play an important role in the determination of global liquidity, defined as the growth and terms of global credit extension. The General Manager illustrated this role by contrasting the growth rates of US dollar credit within and outside the United States. He argued that international credit, including cross-currency credit involving maturity mismatches, tends to amplify domestic credit developments and poses challenges to policymakers. With new institutions and Basel III, policymakers are better equipped to moderate, or at least make the financial system less vulnerable to, swings in global liquidity. But better risk management, better analysis of liquidity risks and better funding strategies on the part of private market participants will be essential.

European Association of Co-operative Banks

(EACB)

Annual report

On 19 May, the EACB published its ➲2010 annual report. The report provides amongst others an overview of financial stability measures such as the new capital requirements and the crisis management framework, the new European supervisory architecture, corporate governance initiatives, taxation of the financial sector and new developments affecting retail banking and consumer issues.

European Banking Federation (EBF)

Mortgage credit

On 27 May, the EBF published its ➲preliminary response to the European Commission's ➲Proposal for a Directive on credit agreements relating to residential property. In the response, the EBF welcomes the aim of the Proposal to ensure an efficient and competitive internal market by restoring consumer confidence, removing barriers to cross-border activity and promoting level playing field between actors. According to the EBF it is of upmost importance to ensure that the level of harmonization does not result in gold-plating practices creating obstacles to the functioning of the internal market. It is confident that a full targeted harmonization approach will genuinely promote a level playing field and consumer protection in the EU. However, since the specific features of the residential mortgage credit markets have to be taken into account, a departure from the principle mentioned above should be allowed only when strictly necessary. However the Federation indicated that it is not convinced that the current Proposal would enhance the cross-border activity of creditors and credit intermediaries, necessary for the smooth functioning of the internal market as the consumers predominantly shop locally for mortgage credit. The EBF did indicate that although the current Proposal does not tackle (in the view of the EBF the current Proposal is not the appropriate legislative instrument to do so) the removal of legal obstacles to cross-border opening of residential mortgage markets, such as diverging legal frameworks of access to credit data and land registers, it is possible that in the future an EU intervention in these areas would be advisable. With regards to the scope of the Proposal, the Federation indicated that it should be limited only to consumers without the possibility for Member States to extend the application to micro-enterprises or a review clause in the Proposal including evaluation on whether small and medium-sized enterprises should be included within its scope in the future. In addition, the EBF stated that the regulatory framework for mortgages must be consistent with the Consumer Credit Directive framework with regard to advertising, pre-contractual information and creditworthiness assessment. Considering the aforementioned, the Federation indicated that adaptation to the specific features of the mortgage credit market should be made only in areas where this is strictly necessary. In this context, the EBF stated that believes that the Commission's attempt to adapt certain provisions

of the Proposal to the mortgage credit market features has gone beyond what is necessary for such a purpose, for example, the requirement to identify products that are not unsuitable. Furthermore, the Proposal sets out a MiFID-like obligation to act in the best interests of the consumer and a conflict of interest rule on remuneration - not only in relation to granting, intermediating or advising on credit but also in relation to ancillary services, regardless of whether the lender is acting in an advisory function or not. In the view of the EBF, the imposition of such a MiFID-like conduct of business rule, not only in relation to intermediating or advising, but also to granting of credit, will prove to be impracticable. Finally, the Federation indicated that it considers the level playing field as pre-requisite for the correct, sound, and safe functioning of the internal market. With this in mind, it welcomes the creation of a regulatory framework for credit intermediaries and the application of the same conduct of business and consumer protection rules to creditors and credit intermediaries.

Export finance and Basel III

On 13 May, the EBF published a ➲position paper titled "Export Finance - The potential impact of the Basel III proposals on 3 ratios - Principal concerns of the European banking industry". In the view of the EBF, the new capital standards as finalized in the December 2010 BIS documents put at risk the availability of short-term trade finance and also medium- and long-term export credit. This would threaten international trade, as well as the economies of emerging markets, which rely heavily on trade finance as an alternative to revolving bank loans, running counter to the G20 goals for economic recovery. In this context, the position paper offers an assessment of conditions in the market for medium and long-term export credit. It then considers how policy makers could adapt the Basel Committee proposals, in particular for three important supervisory ratios (the leverage ratio, short term liquidity ratio and the net stable funding ratio), without undermining the achievement of the prudential objectives of the Committee. The EBF proposals focus on the following key recommendations:

- To fully evaluate the effects of the Leverage Ratio (LR) on the availability of trade and export finance. The Leverage ratio should be kept in Pillar 2 of the Basel framework as an additional tool for supervisors that complements, but does not dominate, the risk-based system of Basel III thereby avoiding the possible negative effects the LR would generate as a binding ratio in Pillar 1.
- To recognize the normal liquidity profile of export credits (cash inflows/repayments and undrawn portion);
- To achieve a real global level playing field in the implementation of Basel III, in particular by harmonizing provisions that allow export credits to be eligible at the refinancing windows of Central Banks.

European Central Bank (ECB)

Bank Recovery and Resolution

On 29 May, the ECB published the ➲Eurosystem's (ESCB) contribution to the European Commission's ➲consultation on technical details of a possible European crisis management framework. In the contribution, the ESCB expressed its support for the plans put forward by the Commission to develop a crisis management and resolution framework for EU financial institutions. It stated that the EU clearly needs better tools with well designed triggers to tackle problems in banks more effectively. National regimes should also be as harmonized as possible and arrangements for better coordination between Member States in crisis situations need to be found. In particular, the ESCB indicated that it shares the view that the overriding policy objective of the new EU regime should be that all institutions can be allowed to fail in a way that safeguards the stability of the EU financial system as a whole and minimizes public costs and economic disruption. According to the ESCB the recovery and resolution scheme should be based on three pillars, namely: (i) an improved and harmonized set of preventative and resolution tools; (ii) clearly defined roles of authorities at the national level accompanied by balanced coordination mechanisms at EU level; and (iii) financing arrangements that limit reliance on public budgets to future crises. It is also important to recognize the international context within which the possible EU framework is being developed. It also emphasized the importance of co-ordination taking into account the relevant initiatives of the Financial Stability Board (FSB) in order to promote the development of a globally consistent approach to bank recovery and resolution.

Bank lending

On 2 May, the ECB published a ➲working paper titled "The bank lending channel: lessons from the crisis". The paper looks at the impact of banks' conditions on the provision of credit and the transmission mechanism of monetary policy during the recent crisis via a sample comprising more than 1,000 listed banks from 15 countries (Austria, Belgium, Denmark, Germany, Greece, Finland, France, Ireland, Italy, the Netherlands, Portugal, Spain, Sweden, the United Kingdom and the United States). It found that changes in banks' funding patterns and business models have modified the transmission mechanism in Europe and in the US. The type of bank funding is a key element in assessing banks' ability to withstand adverse shocks: dependence on short-term market funding and securitization activity seems to be particularly important in this respect. Banks with weaker core capital positions, greater dependence on market funding and on non-interest sources of income restricted the loan supply more strongly during the crisis period. These findings, according to the paper, support the Basel III focus on banks' core capital and on funding liquidity risks. They also call for a more forward-looking approach to the statistical data coverage of the banking sector by central banks. From a more operational perspective, the undoubtedly strong impact of banks' conditions in determining their loan supply calls for an improvement in

the statistical coverage and analysis of the financial sector by central banks. This would include detailed standardized and comparable microeconomic balance-sheet information on individual banks matched with borrowers' conditions (i.e. including banks' lending terms and conditions to individual borrowers).

European Parliament

Deposit guarantee schemes

In its ➲press release of 24 May, the European Parliament announced that the Committee on Economic and Monetary Affairs has voted to uphold the increased bank deposit protection limit of €100,000 but chose to allow Member States more leeway over how they design their schemes. The Committee also decided that the schemes must be fully funded within fifteen years instead of the Commission's proposed ten. Furthermore the Committee decided that depositors should receive their guaranteed savings within five working days, although until the end of 2016 Member States may decide to apply a 20 working day payout deadline. Even in the second scenario though, depositors would still be able to receive €5000 within five working days. The Commission proposed a seven working day deadline. In addition, the Committee would require banks to inform depositors in the event that their deposits are not guaranteed by a deposit guarantee scheme and depositors must be offered the chance to withdraw their money without any penalties. Lastly, depositors are to be informed very directly about how they are protected through their account statements.

European Savings Banks Group (ESBG)

Basel III

On 6 May, the ESBG issued a ➲declaration highlighting its core messages with view to the transposition of Basel III in the EU and to the Internal Market for Payments issue currently on the Agenda of the European Council during the second half of 2011 and beyond. In the declaration the Group underlines that its members look back on long and stable banking traditions, and are closely linked to the real economy at both the local and the regional level. It emphasizes that this part of the banking sector plays a vital role in the European economy and was one of the main stabilizing forces during the financial crisis. The ESBG recalls that the crisis did not originate in Europe's pluralistic retail banking market and thus urges European policy makers to make sure that institutions such as savings and retail banks do not become victims of the new regulation initiatives. Concerning Basel III, ESBG points out that Basel III was designed as a 'one-size-fits-all' set of measures for large internationally active institutions. Nevertheless, for the EU - unlike in the US -, Basel III is to apply to the entire banking sector, in which small and large, regional and international, retail and universal banks of various structures and ownership models compete and co-exist. Thus ESBG stresses that all relevant EU specificities have to be taken into account in the adaptation of the Basel III rules to EU realities The

strong role of retail banks in financing the EU economy must not be undermined, and competition neutrality should be ensured. Equally of great importance are the discussions on Deposit Guarantee Schemes and on Bank Recovery and Resolution. Here, according to the ESBG, European regulation should recognize the capacity of voluntary and mutual guarantee schemes to also serve as early intervention and institutional protection systems. Such schemes should be allowed to play their crucial role as stabilizing factor in the financial market. At last, ESBG expresses its concern with regard to the cumulative impact of the wide range of regulatory initiatives taken in the banking area. This includes not only reforms entailing direct costs (review of Capital Requirements Directive, review of the Deposit Guarantee Schemes, potential resolution funds, possible new or already existing financial sector taxation) but also initiatives increasing the overall complexity, reporting and administrative burden for the banking industry (bank recovery and resolution framework, corporate governance reforms, and guidelines for risk management). While the crisis underlined the need to address these various issues, the accumulating costs and burden of the resulting reforms have to be acknowledged and taken account of in the policy making process.

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Investment products and asset management

Normative documents

Official Journal of the European Union (OJ)

Target2-Securities (T2S)

On 21 May, the ➲Decision of the European Central Bank of 20 April 2011 on the selection of TARGET2-Securities network service providers was published in OJ L 134. The decision sets out the selection and awarding conditions for network service providers. The purpose of the selection procedure is to entrust network service providers to provide a set of predefined connectivity services, on the basis of which the T2S network service providers design, implement, deliver and operate connectivity solutions intended to securely exchange business information between the directly connected T2S actors and the T2S platform.

Consultative or informative documents

CEA

OTC derivatives, central counterparties and trade repositories

On 23 May, the CEA ➲commented on the ➲proposed regulation on OTC derivatives, central counterparties and trade repositories (the so-called European Market

Infrastructure Regulation or EMIR). In its comments the Federation welcomed the aims of EMIR, and as such stated that it believes it should apply to all market participants without exception. Therefore the CEA indicated that it broadly supports the compromise text currently being discussed. However the Federation did indicate that there are a number of key aspects that should still be further considered. Firstly, the CEA stated that it believes that EMIR should attempt to adapt to the different risk profiles of market participants, rather than to provide for exemptions from central clearing for long term investors such as pension funds and insurance companies. To this end European insurers would prefer to see assets other than cash allowed for variation margin and the existing list of 'highly liquid collateral' for initial margin expanded. Secondly, the Federation indicated that, to maintain a level playing field, the exemption from central clearing for intra-group transactions should not be limited to counterparties forming a group wholly established in the EU. This would severely disadvantage European companies forming part of an international group. Intra-group transactions remain a key risk management tool whether a group is based within the EU or outside.

Council of European Union

Investor Compensation Scheme

On 30 May, the Council of the European Union published a ➲Presidency Compromise on the Proposal for a Directive of the European Parliament and of the Council amending Directive 97/9/EC of the European Parliament and of the Council on investor-compensation schemes.

OTC derivatives, central counterparties and trade repositories

On 27 May, the Council of the European Union published a ➲Presidency Compromise on the proposed regulation on OTC derivatives, central counterparties and trade repositories (the so-called European Market Infrastructure Regulation or EMIR).

On 4 May, the Council of the European Union published the ➲opinion of the European Data Protection Supervisor (EDPS) on the ➲proposed regulation on OTC derivatives, central counterparties and trade repositories. In its opinion, the EDPS looks at the data protection implications of the Proposal. The Proposal empowers ESMA to "require records of telephone and data traffic" in order to carry out its duties related to the supervision of trade repositories. In order to be considered necessary and proportionate, the power to require records of telephone and data traffic should be limited to what is appropriate to achieve the objective pursued and not go beyond what is necessary to achieve it, according to the EDPS. As it is currently framed, the provision at stake does not meet these requirements as it is too broadly formulated. In particular, the personal and material scope of the power, the circumstances and the conditions under which it can be used are not sufficiently specified.

The supervisor stated that this comment is also relevant for the application of existing legislation and for other pending and possible future proposals containing equivalent provisions. This is particularly the case where the power in question is entrusted, as in the present proposal, to an EU authority without referring to the specific conditions and procedures laid down in national laws (e.g. the CRA Proposal). Given the above, the EDPS indicted that the legislator, among other things, should clearly specify the categories of telephone and data traffic records which trade repositories are required to retain and/or to provide to the competent authorities. Such data must be adequate relevant and not excessive in relation to the purpose for which they are processed. The power to require access to records of telephone and data traffic should also be limited to trade repositories. Furthermore it should be required that the decision is not to be executed without prior judicial authorization from the national judicial authority of the Member State concerned (at least where such authorization is required under national law). It should only be allowed in case of serious violations of the proposed regulation and in cases where a reasonable suspicion (which should be supported by concrete initial evidence) exists that a breach has been committed Finally, the Commission should consider to adopt implementing measures setting out in detail the procedures to be followed, including adequate security measures and safeguards.

Short selling and certain aspects of credit default swaps

In May, the Council of European Union published several documents relating to the Proposal for a Regulation of the European Parliament and of the Council on short selling and certain aspects of credit default swaps including the ➲Council's general approach as agreed by the Council (Ecofin) on 17 May 2011 and the ➲revised Presidency compromise text of 6 May.

Alternative investment fund managers

On 13 May, the Council of European Union published ➲the text of the Proposal for a Directive of the European Parliament and of the Council on alternative investment fund managers and amending Directives 2004/39/EC and 2009/…/EC as adopted by the European Parliament.

European Fund and Asset Management Association (EFAMA)

Exchange-traded funds (ETFs)

On 24 May, EFAMA published ➲its response to the FSB's ➲note on Potential financial stability issues arising from recent trends in exchange-traded funds (ETFs). In its response the Association indicated that ETFs in the European Union are already subject to one of the most respected and widely recognized frameworks for public investment funds – the UCITS (Undertakings for Collective Investment in Transferable Securities) Directive. In addition, it noted that the concerns raised by the FSB regarding potential conflicts of interest, synthetic exposure, securities lending and the use of collateral are

common across the financial services industry and are managed and mitigated to a large degree within the highly regulated framework of UCITS. UCITS ETFs must comply with the same stringent requirements applicable to all UCITS. Some of the structures mentioned in the Note would not be possible under the UCITS Directive, and in other examples raised the UCITS rules deal with the concerns expressed. Furthermore, EFAMA stated that in order to address the concerns raised in the Note FSB should not to limit itself to ETFs only, as most issues are not unique to them. The FSB as well as other regulators must carry out a comprehensive analysis of all Exchange Traded Products (ETPs) and to make appropriate distinctions among them and their regulatory frameworks (both by product and by jurisdiction). It is very important that a level playing field be maintained (or established, as the case may be) among financial products, and that regulatory arbitrage among ETFs, ETNs, ETCs and other product structures be avoided. Finally, EFAMA commented on a number of concerns articulated by the FSB relating to the liquidity of the product and the liquidity of banks and asset managers involved in exchange traded products. It stated that all UCITS managers are required to employ an appropriate liquidity risk management process in order to ensure that the UCITS is able to meet redemptions. As regards potential liquidity issues for the parties involved in the ETF market, the Association noted that the assets of a UCITS ETF are held segregated from the balance sheets of the UCITS manager, portfolio manager or counterparty. Instead, they are held by the depositary under custody arrangements.

Evolving investment strategies of UCITS

On 16 May, EFAMA published ➲its report on the evolving investment strategies of UCITS. The report shows that the universe and strategies of UCITS are evolving due to investor demand for risk reduction and return enhancement, which is a global trend. Traditionally, UCITS funds have been regarded worldwide as plain vanilla investment funds which only employ traditional investment strategies. However, as allowed by the UCITS III Directive of 2001, there are nowadays more and more UCITS funds that use a wider range of techniques and instruments with the aim of managing the trade-off between risk and return. One of the main examples is using derivative techniques to generate "absolute" returns to the investors. The investor demand for these types of products has significantly increased since the financial markets crisis. In particular, there is clear investor desire to achieve yield uplift relative to the low returns on deposit accounts. At the same time there is a demand from investors for capital security. The reports indicates that the current UCITS legislation provides a robust framework with strong retail investor protection and is about to be enhanced with the UCITS IV requirements. The so-called "Newcits" are neither new products nor a new category of funds. "Newcits" are UCITS that can be described as aiming actively to manage the risk return tradeoff. They are subject to and are managed in compliance with the UCITS framework.

As such they offer the same level of investor protection as other UCITS. Finally, EFAMA indicated that it has full confidence in that ESMA and the national regulators will continue to enforce the UCITS requirements to all UCITS managers in an adequate manner and thereby maintain a level playing field for all UCITS managers to operate and develop products that suit their customers' needs while at the same time providing a high level of investor protection.

Code for External Governance

On 9 May, EFAMA published its ➲Code for External Governance. The purpose of Code is to provide a framework of high-level principles and best practice recommendations which will act as a catalyst for engagement between investment management companies and the companies in which they invest. Adherence to this code will support interaction between investment managers and investee companies and ensure a strong link between governance and the investment process. The principles of the code set out the best practice for investment management companies when they engage with the companies in which they invest. They are designed to enhance the quality of the communication with investee companies and to foster creation of value to investors by dealing effectively with concerns over the companies' performance. The principles of the code are:

- Investment Management Companies should have a documented policy available to the public on whether, and if so how, they exercise their ownership responsibilities.
- Investment Management Companies should monitor their investee companies.
- Investment Management Companies should establish clear guidelines on when and how they will intervene with investee companies to protect and enhance value.
- Investment Management Companies should consider cooperating with other investors, where appropriate, having due regard to applicable rules on acting in concert.
- Investment Management Companies should exercise their voting rights in a considered way.
- Investment Management Companies should report on their exercise of ownership rights and voting activities and have a policy on external governance disclosure.

Responsible Investment

On the same day, EFAMA also published a ➲report on responsible investment (RI). The report aims to describe recent developments in responsible Investment, establish EFAMA's position in relation to responsible Investment and finally suggest some actions going forward. The report shows that responsible Investment is an important feature of the investment management industry with an increasing investor demand in many markets. Having analyzed the developments in Member States, EFAMA concluded that there are a variety of approaches to

responsible Investment not least because even individual investors' perceptions differ as to what can be described as responsible. Therefore the concept cannot be captured by a single regime but a variety of approaches must be allowed. Of key importance in EFAMA's view is that when an investment management company provides responsible investment products, it should commit to an adequate amount of transparency regarding its processes so that investors are able to evaluate and compare how the product meets the RI requirements. Increased transparency of client reporting, communication of investment approaches and selection methods would help investors distinguish between different RI offerings and allow them to make more informed decisions. This would be facilitated by European industry guidance on transparency, to the creation of which EFAMA is strongly committed to contribute.

European Parliament

OTC derivatives, central counterparties and trade repositories

In its ➲press release of 24 May, the European Parliament announced that the European Commission's proposal for a ➲regulation on OTC derivatives, central counterparties and trade repositories was approved with amendments by the Economic Affairs Committee and will now go to the full Parliament for a vote in July. In their vote the Committee members rejected suggestions by some EU Member States that all derivatives should be governed by this regulation. Instead they want the rules to apply only to OTC derivatives, as the Commission proposes and was agreed by the G20 group. However, to ensure ESMA has the full picture, they want reporting obligations to apply to all derivatives. The Committee's report is strict regarding exemptions to the clearing obligation. However, for pension funds there will be a special regime, provided that the national capital requirements provide a guarantee similar to cleared contracts. The Committee accepted that applying clearing obligations retroactively, to existing contracts, would result in legal difficulties and create major problems for counterparties. Therefore, clearing will only be mandatory from the moment the regulation enters into force. It does, however, provide for this possibility with regard to reporting obligations and asks ESMA to assess how reporting retroactivity could be introduced if the information in question were essential to the supervisory authorities.

International Capital Market Association (ICMA)

Retail structured products

In a ➲press release of 23 May, the ICMA announced that the Joint Associations Committee on Retail Structured Products (JAC) is reaffirming the set of ➲principles for managing the provider-distributor relationship (PD Principles) in retail structured products and the ➲principles for managing the distributor-individual investor relationship (DI Principles), originally published

in July 2007 and July 2008 respectively. The Principles were drafted with the intent of achieving fair treatment for individual investors and clarifying the respective roles and responsibilities of the various parties involved in the creation and distribution process. While originally published before the financial crisis, the Principles address many of the same issues as those sought to be addressed by such initiatives and it is in this context that the JAC feels that now is an appropriate time to re-release the Principles in order to both encourage their usage and help inform the current debate.

2011 Global Master Repurchase Agreement

On 16 May, the ICMA published ➲the 2011 version of the Global Master Repurchase Agreement (GMRA), a legal agreement for documenting transactions in the cross-border repo market. At the same time, updated legal opinions on the enforceability of the agreement have also been made available. These cover the use of the GMRA for repo transactions in over 60 jurisdictions. The provisions of the new GMRA 2011 allow market participants to take into account increasingly challenging market conditions in the post-Lehman default environment, changing repo market practice and changing insolvency and bankruptcy regimes. The new agreement also reflects calls for harmonization across master agreements. Finally, the agreement contains:

- an amended methodology in calling an Event of Default;
- an expanded Act of Insolvency definition;
- increased flexibility as regards the default valuation time;
- the concept of margin percentage;
- a cash equivalent amount for margin maintenance where equivalent margin securities are not available; and
- a set-off clause.

International Organization of Securities Commissions (IOSCO)

Dark liquidity

On 19 May, IOSCO published its ➲Principles for Dark Liquidity aiming to assist securities markets authorities in dealing with issues concerning dark liquidity. They establish that pre- and post-trade transparency are central to promoting the efficiency of the market and the integrity of the price formation process. The principles are designed to minimize the adverse impact of the increased use of dark pools and dark orders in transparent markets on the price discovery process by generally promoting pre-trade and post-trade transparency and encouraging the priority of transparent orders. They should also help mitigate the effect of any potential fragmentation of information and liquidity by generally promoting pre-trade and post-trade transparency and consolidation of such information and help to ensure that regulators have access to adequate information to monitor the use of dark pools and dark orders for market monitoring/surveillance purposes and to enable an

appropriate regulatory response to market developments. Furthermore the principles will help to ensure that market participants have sufficient information so that they are able to understand the manner in which orders will be handled and executed. Finally, it should be noted that the principles recognize that a one size fits all approach may not be appropriate for all types of trading or platforms and therefore implementation of the principles may vary according to the type of trading and platform.

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Insurance, reinsurance and pensions

Consultative or informative documents

European Commission

Solvency II

On 5 May, the European Commission published the ➲summary of the response to the ➲consultation on the Solvency II level 2 implementing measures. The summary shows that stakeholders' concerns relate to a small number of key issues, namely the impact on long-term products, volatility and pro-cyclicality, proportionality and limiting the reporting burden and the need for transitional measures in certain areas. With regard to long-term products there is the concern that the level 2 implementing measures as set out in the technical specifications for the fifth quantitative impact study (QIS5) will not make it viable for insurers to continue to offer these types of products. The problem is in large part related to the volatility of the value of assets and liabilities under a market consistent valuation framework and the measurement of the specific risks that undertakings offering these products are exposed to. On the issue of pro-cyclicality, Respondents indicated the need to ensure that mechanisms designed to address procyclicality, such as the Pillar I dampener, work effectively and do not create artificial volatility. Respondents also raised the issue of pro-cyclicality in relation to the policy issue on the limits for own funds where it was noted that applying the limits to total own funds, rather than the own funds being used to meet the Solvency Capital Requirement (SCR), could have pro-cyclical effects. Furthermore a large number of responses were received on the policy issues on supervisory reporting and public disclosure. Many responses cited the need for a concrete application of the proportionality principle in relation to the Pillar III requirements, for example through exempting certain undertakings from the quarterly reporting based on the size, nature and complexity of the risks in their business. More generally, the need to have concrete applications of the proportionality principle across all three of the Solvency II pillars was stressed. Finally, the need for transitional measures in certain areas to ensure a smooth transition

to the new Solvency II regime and to avoid market disruption was noted. Specific areas where respondents deem transitional measures to be necessary include own funds, reporting requirements and third country equivalence.

In the summary, the Commission indicated that it has set up working parties to develop solutions to several of these issues. The responses together with the results of the fifth quantitative impact study (QIS5) will serve as input when preparing the impact assessment, which will accompany the Commission's proposal for the level 2 implementing measures.

Financial Services and Markets Authorities (FSMA)[3]

Solvency II

On 5 May, the FSMA published the ➲advice of the Insurance Commission on orientation notes of the CBFA with regard to the policy options afforded to the Member States by the Directive of the European Parliament and the of the Council on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II). The CBFA detailed these options in two orientation notes. One note detailed the options with a larger impact while the other note set out the options with no or only a limited impact. The notes also provided a first indication on how the different options would be taken into account when transposing the Directive. The notes are currently the subject of open consultation. In its advice, the Insurance Commission analyses and comments on each of the listed options.

Supplementary pensions

On 3 May, the FSMA published the advice of the Commission on Supplementary Pensions with regard to the term "uittreding" or "sortie" in the sense of the Law of 28 April 2003 on Supplementary Pensions (in ➲Dutch and in ➲French). "Uittreding" or "sortie" from the pension scheme will in principle occur when the employment contract is terminated or when a company is taken over without the transfer of pension rights. At that moment the rights of the member of the scheme and the obligations of the organizer are determined. The fact that the principle "uittreding" or "sortie" ties the end of the membership of the scheme to the end of the employment is however problematic in certain situations such as when an employee is transferring from one participating employer to another. In that situation the principle of "uittreding" or "sortie" would cause the employee to lose membership in the scheme due to termination of employment. To mitigate this problem, the Commission on Supplementary Pensions proposes to amend the text of the Law of 28 April 2003 to allow organizer of supplementary pension schemes to organize the transfer of rights which would take the form of a debt roll-over. The transfer of the right would be set out in a so-called "uittreding" or "sortie"-agreement which neutralize the negative consequences of the "uittreding" or "sortie" for

the employee. To ensure clarify for all parties with regards to rights and obligations the modalities of the "uittreding" or "sortie"-agreement must be mentioned in the pension scheme rules.

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[3] As of 1 April 2011, the new "Twin Peaks" supervisory architecture has come into force in Belgium. The new architecture replaces the Banking, Finance and Insurance Commission (CBFA) with two new regulators, the National Bank of Belgium (NBB) and the newly created Financial Services and Markets Authority (FSMA). Within the new framework FSMA is responsible for the supervision of the financial markets and the "conduct of business" rules, the micro-prudential supervision of portfolio management and investment advice companies, UCI management companies and UCI's, institutions for occupational pension, financial intermediaries, the financial education of investors and their protection against the illicit provision of financial products and services.

National Bank of Belgium (NBB)[4]

Solvency II

On 11 May, the NBB published a letter to the insurance undertakings with regard to the use company-specific factors within the context of Solvency II (in ➲Dutch and in ➲French). In the letter the NBB requested insurance undertakings to indicate their intentions with regard to the use of company-specific factors (replacing a subset of parameters in the standard formula) for the calculation of their regulatory capital by 31 May. The undertakings were also asked to provide an overview of the relevant sub modules, the specific parameters per sub module and a justification of why the original parameters were not suitable by the same date.

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Organization for Economic Co-operation and Development (OECD)

Insurer Governance

On 27 May, the OECD published ➲its revised guidelines on Insurer Governance. The new Guidelines seek to reflect lessons learned from the financial crisis, including the need for a board with necessary leadership, expertise, and independent decision-making, effective risk management and internal control systems and integrated firm-wide reporting within an insurer, sound compensation arrangements, and well understood group structures. They recognize that insurer corporate governance should, in particular, be comprised of the following key elements:

- Expected prudent approach to business and financial strategies, consistent with the role of

insurance in the economy and, where relevant, social security systems;

- Well developed risk culture and risk management and internal control systems, supported by effective and independent control functions;
- High level of financial expertise among board members and within senior management; and,
- Policies and procedures that ensure proper treatment of customers and policyholders (and any relevant beneficiaries), including mechanisms for redress.

The Guidelines are intended to provide guidance and serve as a reference point for insurers, governmental authorities, and other relevant stakeholders in OECD and non-OECD countries.

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Tax

Normative documents

Official Journal of Belgium (BS/MB)

On 6 May, the Law of 14 April 2011 containing miscellaneous provisions (hereafter referred to as the "Law") was published in the Official Journal of 6 May 2011 (in ➲Dutch and in ➲French). This Law contains a chapter modifying various tax provisions, mainly to bring them to compliance with European law. The following modifications are relevant for the financial sector:

- Deduction of interest expenses: In tax law the general principle is that interest is only deductible if it is at arm's length. By way of exception, interest are deemed to be at arm's length in three cases, among others when the interest is paid to credit institutions governed by the Law of 22 March 1993 or certain other similar institutions. The new law updates and expands the list of qualifying institutions for this purpose, which is applicable as of January 1, 2011.
- Dividend received deduction: the law removes the condition that the participation from which the dividend is received, should qualify as "financial fixed assets" for accounting purposes, and allows imputation on certain disallowed items and carry-forward of excess dividend received deduction for dividends from companies located in the EEA.
- Notional interest deduction: definition of concept "financial fixed assets" for financial institutions is incorporated in tax law; this however is not a new definition.
- Dividend withholding tax: The reduced rate of 15% for dividends distributed (i) by recognised investment companies as well as (ii) by quoted companies, or those of which part of the capital has been contributed by a PRIVAK and whose

voting shares are owned by more than 50% by one or more individuals is extended to dividends from similar companies established in the EEA.
- Bank secrecy: The provisions in the Law reduce the scope of the Belgian bank secrecy, giving the tax authorities the possibility to get information from banks with respect to their clients if they have indications of tax fraud or greater wealth. The tax authorities can only submit such request if they have first tried to obtain the information from the taxpayer himself.
- The Law also mandates the creation of a 'Central Contact Point' with the National Bank of Belgium to which the banks are obliged to communicate the names, accounts and contract numbers of their clients. The tax authorities can request this data where there are indications of tax fraud.

Belgian Tax Authorities (FOD Financiën)

80%-rule: indexation of 'current revenue' for 2010

On 12 May, the Belgian Tax Authorities published a ➲circular letter with respect to the calculation of the tax deductible contributions made by employers to group insurance schemes. Contributions paid by corporations with respect to complementary pension plans (group insurance, pension fund, individual agreement) are only tax deductible if they meet the so-called 80%-rule. This means that the state and complementary pensions, expressed in annual revenue, do not exceed 80% of the last normal gross annual salary of the concerned employee. With respect to current pensioners, an indexation of the initial pension revenue is possible.

Consultative or informative documents

CEA

The Future of VAT

On May 31, the CEA published its ➲response to the ➲European Commission's consultation on the future of VAT. In its response the CEA emphasizes the need to adopt comprehensive and consistent exemptions regarding the outsourcing of insurance services via other means than brokers or agents (e.g. via IT platforms, networks…). CEA also pleads for diminution of administrative burden related to cross-border activities and proposes to introduce a one stop shop mechanism, allowing a multiple member state registration and to increase the competences of the VAT committee. The CEA also claims for a pan European VAT grouping and cost-sharing agreements and for the implementation of clear rules in that regard.

Council of European Union

Taxation of the financial sector

On 12 May, the Council of European Union published the ➲Draft Report to the Ecofin on financial levies and taxes.

Based on a questionnaire on the implementation of taxes and levies on the financial institutions to the Member States, this report provides the state of play in respect of the implementation by Member States of such systems of levies and taxes as well as of short term issues resulting from their implementation. It found that so far only ten Member States have introduced systems of levies and taxes (DE, UK, FR, SE, PT, LV, DK, AT, HU and CY) whose parameters (base, rate and scope) differ considerably. Belgium has introduced a levy, but not in the sense of a levy or tax to contribute to resolution. Four more countries are currently in the process of introducing systems of levies and taxes (SK, PL, IE, SI; see annex 2), whereas other Member States are favorably disposed towards or could consider introducing systems of levies or taxes at a later stage (NL), when there is more clarity in terms of EU coordination, the inference with other regulatory measures and the credit supply effects or, would consider introducing them in the context of an EU-wide approach on crisis resolution (LT, LU, EE, RO and BU). Greece will decide on the issue only after the current tax on most profitable firms is expired (2013). Malta and the Czech Republic do not intend to introduce such systems in the future. The report also highlights that a double charging issue on cross border financial institutions may arise if a country introduces a levy that also covers:

- subsidiaries of its own financial institutions in other EU countries (which is the case for both the FR and UK levies) AND/OR,
- on its own territory, foreign branches of EU banks (which is the case of AT, CY, HU, LV and the UK).

In view of addressing the double charging issue, only the UK-FR agreement, which addresses the issue on a bilateral basis, has been reported.

European Association of Public Banks (EAPB)

The Future of VAT

On 31 May, the EAPB published ➲its response to the ➲European Commission's consultation on the future of VAT. In the response, the Association stated that there is a general need to modernize and simplify the current VAT system. Existing derogations, different VAT rates and options for Member States counteract a uniform application of the VAT legislation in the EU. It also indicated that the VAT exemption for financial services should be kept but needs adjustments. Exemption from VAT means that VAT is not charged to the purchaser and VAT paid on related inputs is not recovered. This results in the over-taxation of suppliers of exempted financial services. It also results in the under-taxation of final consumers. Final consumers do not pay tax on the full value added by financial service providers. Achieving or maintaining a level playing field between EU- and non-EU banks or other players in the financial sector who are not exempt is important in a globalized world with high-tech IT solutions. The legal framework on exempting financial services from VAT should contain a general possibility to opt for taxation or financial services should be zero-rated. An option to tax provides the supplier with an opportunity

to allow for full VAT expense recovery. According to the Association, the aforementioned problems can be solved by increasing legal certainty and improving the neutrality of VAT for credit institutions. The best way to solve the problems would be VAT exempting financial services with a full input tax deduction. However input tax deduction faces problems where a classification according to VAT taxable or VAT exempt turnover is not possible. Different calculation methods exist across the Member States with respect to determining the allocation of the input tax deduction. These inconsistencies within the EU cause distortion of competition between business operators in different Member States. The EAPB indicated that the current system of partial exemption of financial services has led to a system of deduction that is complex and applied in an inconsistent manner across Member States. Harmonization in the field of deductions and a level playing field can only be achieved with the use of a single set of guidelines. Finally, the Association stated that the proposed collection of tax via financial intermediaries would put nearly the whole burden of collecting VAT on the financial sector. It would necessitate a complete change of the present payment- and money transfer-system. This would lead to an additional significant administrative burden on financial institutions. According to the EAPB, a financial institution should not be put upon any obligation to control the correctness of the payment. Financial institutions should not be burdened with becoming the vicarious agent of the tax administration.

European Banking Federation (EBF)

The Future of VAT

On May 26, the EBF published ➲its response to the ➲European Commission's consultation on the future of VAT. In its response the EBF pleads for introducing a general option for taxation or a zero rating on financial service; for cross-border VAT grouping and cost sharing association and for measures against administrative burden that companies can encounter by performing financial services in different member states.

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