Position paper
of the Association of German Banks on capital markets union 2020

19 February 2020
Eight demands for true capital markets union

1. **More efficient EU securities markets**: It should be just as convenient and inexpensive for investors to invest in securities throughout the EU as it is to invest in domestic securities. The servicing of their assets should not give rise to any new, complex processes with associated additional costs. EU-wide standardisation of processes to settle trades and enable asset servicing will not only foster an investment culture but will also increase efficiency.

2. **Targeted harmonisation of insolvency law**: Measures intended by EU legislation to protect capital market participants against the default risk of a counterparty must also be legally effective. The legal assessment of collateral and netting agreements therefore needs to be the same across the EU to exclude the possibility of doubt about the enforceability of such protection, especially in the event of insolvency.

3. **Proportionate investor protection**: Investor protection rules should protect investors against risks. But the most recent changes under MiFID II and the PRIIPs Regulation have led to investors no longer being able to buy capital market products designed and suitable for them because the rules governing distribution are inconsistent, incomprehensible or excessive and provide for no differentiation between investors in terms of their knowledge and experience. This needs to be remedied.

4. **Strengthen the securitisations market**: High-quality securitisation tranches, which proved secure even during the financial crisis, should not be discriminated against compared to other financial products. Especially as they provide an urgently needed bridge between bank lending and the capital market funding.

5. **Set up sandboxes**: Sandboxes are an efficient means of developing digital business ideas in close cooperation with supervisors. They also offer an opportunity to suspend existing requirements under supervision in an enclosed environment so that the effects of new technologies can be tested. To strengthen Europe’s position as a digital capital market, we need a coordinated system of European sandboxes.

6. **Align tax bases**: Corporate tax bases need to be harmonised in the EU so that businesses active purely at national level and those operating across borders face the same taxation framework. This will also enable tax loopholes to be closed and a level playing field to be established.

7. **Call off financial transaction tax**: Investors – be they retail or business – must not be burdened with a special tax on transactions in shares. The tax would put at risk private provision for old age and the financing of businesses in the EU.

8. **Review VAT on financial services**: Additional VAT costs frequently frustrate the creation of efficient business structures. To ensure the competitiveness of European banks in global financial markets, these costs must be avoided.
Europe needs true capital markets union

Ideally, everyone would benefit from further deepening and cross-border consolidation of the capital markets in the European Union: states, businesses and citizens. Enhanced competitiveness, innovative strength and sovereignty for the EU economy, greater financial stability, more diversified access for companies (and public-sector organisations) to debt and equity financing in all parts of Europe and, last but not least, the participation of investors in growth and prosperity – these are all arguments in favour of making the necessary political efforts to achieve true capital markets union.

The capital market brings together investors on the one hand and issuers on the other, thus working as an alternative to the deposit-loan intermediation of banks. Expanding capital markets will therefore affect both sides, investors and issuers, as well as the intermediation that takes place between them. Banks are – and always have been – important, tried and tested intermediaries and central service providers in the capital market. Investors and issuers are among the banks’ clients, so banks have an interest in ensuring that the needs of both sides are met. At the same time, banks themselves have an interest in ensuring that capital market processes run as efficiently as possible, including across national borders.

Political measures to promote capital markets union will benefit all sides if the interests of all parties involved are in an appropriate relationship to one another, i.e. if a balance can be struck in the structural conflict between investors’ need for protection and issuers’ funding objectives are in equilibrium. Too easy access to the market for companies normally runs counter to the interests of investors; too extensive protection of investors is against the interests of issuers. Too great an imbalance would ultimately be at everyone’s expense.

From the investor’s perspective, it is important that capital markets union gives investors diversified, transparent and not least uncomplicated access to capital markets throughout the EU and that holding and servicing capital market products is simple and efficient. This requires appropriate regulation and a level of investor protection that ensures investors have the information they need but does not compromise their freedom to make their own decisions or absolve them from personal responsibility. From the perspective of companies and public organisations seeking capital, it is important that they can obtain the kind of financing they need for their business, investments and growth. This financing should naturally be as inexpensive as possible, but innovative options should also be available and funding should be dependable in the long term. Capital-seeking entities want to be able to fulfil their obligations as unbureaucratically as possible and communicate easily with their capital providers. These criteria can be met by issuing capital market products but the process must be carried out as efficiently as possible and, if necessary, across borders. For small and medium-sized enterprises, on the other hand, or for companies that do not wish to be publicly traded, securitisation of the tried and tested bank loan or a private placement arranged by banks offer a possible way of tapping new sources of funding in the market. And for innovative founders and high-growth companies, the expansion of the venture capital market in Europe is key.
Both the existing rules, regulations and practices in member states and appropriate EU legislation will play a central role in deepening an EU capital market. Today’s markets developed historically out of national legal regimes. To strengthen the cross-border market, it will be necessary to build on tried and tested legal systems and concepts – but also to take steps towards their harmonisation in certain targeted areas, though without necessarily basing EU-wide solutions on the most or least stringent national rules. Deepening and integrating capital markets will also require the elimination or at least mitigation of tax obstacles where they have a negative impact on cross-border investment and thus on growth.

On the basis of efficient and robust legal principles which are applicable throughout Europe, market participants will be able to develop solutions and products that meet the needs of businesses and prove to be competitive over time. A uniform EU-wide framework that promotes and protects the objectives and interests of capital market participants is indispensable in this context. Such an approach makes far better sense than prescribing individual, standardised EU-wide products.

A number of different measures are necessary to establish a framework along these lines. The Association of German Banks would like to outline those it currently considers the most important.
1. More efficient EU securities markets

I. What problem, what obstacles need to be overcome?

The creation of a harmonised and efficient European capital market has long been one of the European Union’s primary objectives. This is because, first, the capital market offers both businesses and the public sector the opportunity to cover their financing needs by issuing capital market products instead of taking out bank loans, thus consolidating funds from a number of sources, i.e. investors. Conversely, companies, public authorities and private individuals are able not only to place funds with banks in the form of deposits but can also make them available to others by investing in capital market products, thereby earning income and possibly participating in the appreciation of the value of their investment. In other words, their capital is accessible to the market to be used as an alternative to bank loans.

From a purely financial point of view, it makes no difference to investors whether the product they invest in has been issued in Germany, France, Italy or another EU member state. Issuers, for their part, want to have the broadest possible access to investors throughout the EU. But capital market products in the EU are subject to numerous national civil law requirements, such as those of company, securities and insolvency law, as well as national tax rules and regulatory requirements. As a result, and for historical reasons, too, processes for settling trades, holding assets in custody and asset servicing are also inconsistent across the EU.

At the instigation of the European Commission, the Giovannini Group was set up in 1996 to identify the obstacles to cross-border capital market activities, especially in the area of the clearing and settlement of securities, custody and asset servicing in the EU. These obstacles, known as Giovannini barriers, were described in two reports and broken down into operational, legal and tax barriers. The group also issued recommendations for eliminating the various barriers with the involvement of all market participants concerned. Since then, it has been possible to eliminate differences in the rules governing corporate actions, for example, by developing comprehensive market standards for processing of all types of action. Today, almost uniform procedures for dealing with corporate actions exist in the EU, which has led to corresponding efficiency gains.

The advantage of harmonising different legal requirements and operational processes is that it further reduces the obstacles to cross-border investment in capital market products since, from the investor’s point of view, the investment and asset management opportunities are the same as those in their home state and consequently generate no additional costs. Although progress has been made on harmonisation since the publication of the Giovannini reports, not all barriers have yet been removed and some new ones have even been erected in the meantime.

At the beginning of 2016, the European Commission therefore set up the European Post Trade Forum (EPTF) to review developments in post-trading with the aim of promoting more efficient and resilient market infrastructures. To this end, the EPTF carried out in-depth analysis of the
current structures governing all post-trading activities relating to capital market products, reviewed the current status of the Giovannini barriers and identified new barriers. In May 2017 it submitted an extensive report on the existing obstacles to the European Commission, together with proposals for overcoming them.

II. What solution, what objectives are we seeking?

To establish a functioning capital markets union, certain barriers identified in the EPTF report should be prioritised and eliminated. It should be as convenient and inexpensive for investors to make cross-border investments in securities as it is to invest in domestic securities. Issuers would then have access to investors outside their own member state. It would also increase the efficiency of the processes involved.

The ultimate aim should be to have no obstacles to post-trading activities within the EU.

III. What (legal, regulatory, other) changes are needed?

The Association of German Banks recommends rigorously pursuing all ongoing harmonisation efforts, especially in the post-trade sector. Since the existing obstacles are due to operational, legal and tax differences between member states, solutions should take the form of self-regulation by market participants (such as standard-setting and the establishment of market practices), supported by changes to current EU legislation.

To achieve this goal, we would recommend targeted changes in the following areas identified by the EPTF report:

1. **EPTF BARRIER 6: Complexity of post-trade reporting structures**
   There should be a particular focus on concrete changes to transaction reporting requirements concerning, for example,
   a. client and staff data
   b. reporting transfers of securities
   c. reporting corporate actions
   d. flagging short sales
   e. reporting securities financing transactions (SFTs) with central banks
   f. the transfer of the reporting requirement under Article 9(1)(a) of the European Market Infrastructure Regulation (EMIR) as amended by the EMIR Refit.

2. **EPTF BARRIERS 1 and 5: Fragmented corporate actions and general meeting processes**
   a. Further harmonisation of corporate action processes, especially with respect to collateral management
b. Removal of the option in the Shareholders’ Rights Directive (SRD2), which could lead to further fragmentation of processes for shareholder identification

3. EPTF BARRIER 4: Inconsistent application of asset segregation rules for securities accounts
   a. Clarification of various holding models in the EU and their legal consequences
   b. Proposal for enshrining in EU law the concept of the so-called non-property presumption (Fremdvermutung) under Section 4(1), sentence 1 of the German Safe Custody Act (for details see section 2 on harmonising insolvency law below)

We welcome, in principle, measures to promote sustainability aspects in the financial sector (sustainable finance). These measures should, however, continue to offer the necessary room for manoeuvre when issuing “green” financial instruments and should be particularly careful not to disregard considerations of international competitiveness. In addition, grandfathering arrangements should ensure that products issued on the basis of “green” market standards at the time of issue do not lose this label at a later date.
2. Targeted harmonisation of insolvency law

I. What problem, what obstacles need to be overcome?

There are, for instance, legal obstacles to processing securities transactions. These include the treatment and legal classification of financial collateral, especially in the event that a party to the transaction defaults or becomes insolvent.

In its 2017 report, the European Post Trade Forum (EPTF) found that there was uncertainty surrounding the ability to rely on the legal recognition of desirable, tried and tested risk mitigation techniques. This uncertainty affects collateral used both (bilaterally) by intermediaries and by central counterparties (CCPs) in their default management processes. The report calls this obstacle “EPTF BARRIER 8: Uncertainty as to the legal soundness of risk mitigation techniques used by intermediaries and of CCPs’ default management procedures.” As a result of this obstacle, risk mitigation techniques specifically required by the European Financial Collateral Directive (FCD) do not, in practice, have the necessary legal recognition in all member states.

Intermediaries and their clients usually manage counterparty default risk with the help of collateral and netting agreements. These are concluded in case one party becomes insolvent. But the current legal regime in the EU has proved to have weaknesses, giving rise to doubts about whether it limits risk as effectively as it should. Especially where cross-border transactions are concerned, the netting agreements intended by the FCD to protect market participants are not always sufficient because their enforceability is assessed differently across member states. This means that even within the EU, parties to a contract have to examine whether the agreements used will be enforceable in each member state and adapt them, if necessary, to the local circumstances. In the view of the EPTF, this general uncertainty has been further exacerbated by the Bank Recovery and Resolution Directive (BRRD). Yet the whole purpose of collateral and netting agreements is to enable contracting parties to minimise their risks without needing to carry out any further checks or analysis of their counterparty. Additional legal uncertainty may be introduced by the European Restructuring and Insolvency Directive and its transposition into German law.

II. What solution, what objectives are we seeking?

In a functioning capital markets union, there should be no legal uncertainty about the effectiveness of collateral and netting agreements. Financial collateral arrangements should have the same legal status in a cross-border transaction as in a transaction within a member state and, if one party becomes insolvent, they should be enforceable legally and in practice, even across borders. Firms that use securities to collateralise their transactions or in their liquidity management processes should not have to bear any associated legal and thus financial risks.

And in the event of the insolvency of an intermediary in the custody chain, no uncertainty should arise as to whether client securities belong to the insolvent intermediary or its customers.
III. What (legal, regulatory, other) changes are needed?

The Association of German Banks recommends targeted measures to harmonise the requirements of insolvency law.

1. Clarification of the legal recognition of risk mitigation techniques employed by market participants in the form of collateral and netting agreements. It should be possible to use agreements of this kind in the same way in all member states, meaning they should also be enforceable across borders. Corresponding clarification by EU and national lawmakers is also required in connection with the restructuring and resolution of banks or their contractual partners.

In addition, a provision could be added to the FCD to clarify the position under civil law with respect to the acquisition and sale of financial collateral in accordance with the FCD and to improve the enforceability of collateral agreements.

2. When it comes to the question of who securities belong to in the event of an intermediary becoming insolvent, different names given to securities accounts and the recording of securities in different accounts is normally irrelevant from a civil law perspective. In the past, requirements concerning account segregation in various EU laws (MiFID, AIFMD, UCITS, CSDR, EMIR) have brought more uncertainty than clarity since the relevant national civil law requirements have been ignored.

A key issue, on the other hand, is the civil law background and the recognition of the legal status under the applicable requirements of insolvency law in member states. The Association of German Banks therefore recommends considering the idea of enshrining in EU law the so-called non-property presumption (as in Section 4(1), sentence 1 of the German Safe Custody Act) in order to protect investors at EU level. This would introduce a legal presumption that holdings of securities which an account-administering bank has entrusted to another custodian normally belong not to the bank administering the account but to its customers. It would then be unnecessary to explicitly spell this point out or to record customers’ holdings in a separate account in order to protect client assets in the event of the intermediary’s insolvency.
3. Proportionate investor protection

I. What problem, what obstacles need to be overcome?

The creation of a harmonised and efficient European capital market has long been one of the major objectives of the European Union. Legislation such as MiFID II and the PRIIPs Regulation were intended to provide regulatory support and achieve EU-wide harmonisation of – among other things – investor-protection requirements when selling securities products.

The new requirements of MiFID II are so extensive and detailed, however, that many banks have significantly reduced the number of products and services they offer. At the same time, customer frustration – especially with the further increase in the flood of information they receive – has significantly risen. The upshot is that, since the introduction of MiFID II, the readiness of customers to invest in the capital markets has not grown at all. Given the high cost of implementing the directive, this is highly unsatisfactory.

Owing to the unclear scope of the PRIIPs Regulation, products such as corporate bonds with a so-called “make whole” provision are no longer sold to retail investors. This reduces the range of financial products available to these investors even though corporate bonds are perfectly suitable for the retail investor. It has also created an obstacle for companies since the exclusion of retail clients means they can no longer access the entire capital market for the sale of their bonds.

On top of that, the various cost transparency requirements under MiFID II and the PRIIPs Regulation are inconsistent with one another, leading to a duplication of information about product costs. Since these costs have to be calculated on a different basis under MiFID II and the PRIIPs Regulation, moreover, the costs for the same product may be presented differently.

II. What solution, what objectives are we seeking?

We believe an adequate level of investor protection is essential to a smoothly functioning capital markets union. Investor protection rules should be clear and unambiguous, however. Uncertainty about their application should be avoided, information should be consistent and should not have to be duplicated because of requirements in various EU laws. It should also be possible to treat customers differently according to their knowledge and experience of financial products. Professional investors and eligible counterparties need to be provided with less information than do retail investors, for instance.

Unclear and excessive legal requirements that generate uncertainty and make it impossible to offer investors suitable products or more difficult for companies to access investors should be rectified.
III. What (legal, regulatory, other) changes are needed?

The Association of German Banks recommends amending some of the requirements of the PRIIPs Regulation and MiFID II.

1. The scope of the PRIIPs Regulation should be clarified. It is especially important to ensure that products which are suitable for sale to retail investors in principle are not excluded from sale in practice.

2. Coherent regulation should avoid the need to duplicate information on product costs. It should at least be ensured that “duplicate” information about costs from the manufacturer/issuer and the distributor is calculated on the basis of the same principles. The key information document could then dispense with information on costs if the product in question was a financial instrument within the meaning of MiFID II. Coherence along these lines would not be difficult to achieve.

3. It should be possible to tailor the treatment of customers to their level of knowledge and experience.
4. Strengthen the securitisations market

I. What problem, what obstacles need to be overcome?

Securitisations were stigmatised in the wake of the financial crisis since investors suffered large losses in certain sub-segments of the securitisations market in the US. In Europe, there was no such failure in the securitisations market. Nevertheless, securitisations were regulated more strictly overall as a result. As always, however, the important thing is to have the right level of regulation. While it is very welcome that re-securitisations, which led to the crisis, were banned, more stringent regulation was simultaneously introduced for securitisations that serve to finance the economy and suffered virtually no defaults even during the financial crisis. Other products that performed similarly well, such as covered bonds, are treated much more favourably. Instruments of this kind are subject to lower capital requirements, for instance, or qualify as more highly liquid under the Liquidity Coverage Ratio Regulation, where they are assigned to higher HQLA levels.

This disadvantageous treatment makes securitisations more expensive even though securitisations are predestined to bridge the gap between bank lending and capital market funding. No other instrument is as good at opening up the strongly loan-driven funding of small and medium-sized businesses in Europe to the capital market, thus ensuring that risks are spread more widely.

Due to their structure, securitisations initially generate additional costs, so banks need to conduct profitability analyses to weigh up whether they should leave the risks on their own books or transfer them to the capital market. As a result of the new regulatory requirements introduced by the Simple, Transparent and Standardised (STS) Regulation for securitisations at the beginning of 2019, risk weights, including for high-quality securitisations, have increased. In parallel, other regulatory costs have risen. The increased costs can make securitisation uneconomical. Where regulatory relief is possible without lowering the level of security, it should be provided.

II. What solution, what objectives are we seeking?

We need a functioning securitisation market that allows us to spread risks evenly across the banking and capital markets in order to increase financial stability, ensure the financing of businesses and combat climate change. High-quality securitisation tranches should therefore be promoted and not disadvantaged compared to other financial instruments of equal quality.
III. What (legal, regulatory, other) changes are needed?

The European securitisation market is slowly picking up again after a long pause. In order not to disrupt this process, changes to regulation should be made cautiously. Banks and stakeholders have already adapted to the new requirements, so these should not be radically overhauled. On the other hand, adjustments such as the risk weighting of securitisations and the assignment to HQLA levels should be made. In addition, disclosure requirements should be reviewed to see whether they are fit for purpose and synthetic securitisations should be given an STS framework with lower risk weights.

1. Risk weights

When the regulation of securitisations was revised, the minimum risk weights for the highest-quality tranches increased from 7% to at least 10% for STS and at least 15% for non-STS securitisations. As a result, high-quality tranches are hit especially hard. We recommend lowering the minimum risk weights. A more risk-sensitive floor could also be considered. In addition, there should be a fundamental review of the appropriateness of the risk weights. Thought should also be given to the idea of a separate calibration for top-prime securitisation segments, such as auto asset-backed securities (ABS) and European prime residential mortgage-based securities (RMBS).

On top of that, the risk weights for non-performing loans (NPLs) should be adjusted. The calculation methods under the new securitisation regime produce significantly higher risk weights than is justified by the actual remaining risk of default. Insufficient account is taken of the write-off of NPLs. Securitisation of NPLs can do a lot to help reduce NPL stocks in banks.

The risk weights under Solvency II should also be adjusted to give insurance companies, an important sector of the capital market, better access to securitisation. The risk weights for equally high-quality securitisations are up to 39 times higher for insurance companies than for banks. Considering the default risks to which insurers are exposed when they purchase a securitisation for the purpose of holding it, these risk weights are inappropriate. Furthermore, insurance companies should also be able to invest in asset-backed commercial paper (ABCP) securitisations if they have a fully covered liquidity line.

2. High-quality liquidity assets (HQLAs)

Haircuts on RMBS and auto ABS (25%) and on securitisations of SME loans (35%) should be dropped. To this end, Article 13(14) of Delegated Regulation (EU) 2015/61 (LCR) should be deleted.

STS securitisations of the highest credit quality and with a minimum issue size of €250 million should be recognised as level 2A assets like the covered bonds mentioned in
Article 11(1)(c) of the LCR Delegated Regulation so as to eliminate discrimination against high-quality and highly liquid STS securitisations compared to such covered bonds.

3. Disclosure
Disclosure requirements should not apply to ABCP and other securitisations in which only a few institutional investors are involved and which are not placed publicly. Investors in transactions of this kind request the information they need bilaterally and already have sufficient data at their disposal. A general, more extensive disclosure obligation for such transactions is an unnecessary cost factor offering no added value.

4. Synthetic STS securitisations
Synthetic securitisations should also be able to benefit from appropriate STS risk weights. Synthetic securitisations are not part of the STS framework at present, though the EBA is consulting on whether to include them. We are strongly in favour of synthetic securitisations. They function in a similar way to other securitisations but do not require a special purpose vehicle as a normal securitisation is merely contractually “replicated”. The leaner structure of a synthetic securitisation makes it less costly, meaning the transfer of risk to the capital market is even more efficient.

5. Creating legal certainty
The substantial sanctions for breaches of the securitisation framework makes legal certainty especially important since market participants will otherwise be deterred from investing in securitisations. Yet the geographical scope of the regulation, for example, is unclear. There is also a need to clarify which competent authority is responsible for supervising compliance with matters such as risk retention requirements.
5. Set up sandboxes

I. What problem, what obstacles need to be overcome?

Digital solutions are particularly predestined for cross-border use. A prerequisite, however, is a single, forward-looking digital capital market that enables digital products to be sold throughout Europe.

To promote innovations, legal certainty needs to be established as quickly as possible in the country of origin. But a uniform approach to dealing with innovations needs to be ensured across Europe, too.

One way of quickly achieving legal certainty is the use of sandboxes, which allow a close exchange of ideas and views between innovators and their supervisors. Unfortunately, only a few EU member states currently have active sandboxes for testing new digital products. This is not enough to promote innovation in Europe.

It is true that the EBA and European Commission have already launched initiatives to ensure a level playing field by establishing an exchange of experience between national supervisors about their sandboxes. But owing to the small number of sandboxes in the EU, this exchange is extremely limited. Germany, in particular, has come out strongly against establishing a sandbox in the past.

II. What solution, what objectives are we seeking?

To be able to develop new digital financial products, innovators such as banks and fintechs must be in a position to try out their ideas quickly and efficiently. They need an opportunity to swiftly engage in dialogue with supervisors so that products can be adjusted to meet regulatory requirements at an early stage. But they also need an experimental space where ideas and their consequences can be tested in an enclosed environment.

We are therefore seeking the establishment of sandboxes in as many member states as possible, with coordination that is as close as possible. Consideration should be given to the idea of ultimately creating a European sandbox.

III. What (legal, regulatory, other) changes are needed?

A sandbox does not necessarily mean lower regulatory requirements. The first step should be to establish a number of national sandboxes that enable close cooperation between innovators and supervisors.
Only in a second step could thought then be given to the idea of temporarily lifting regulatory requirements. Since many of these requirements are rooted in EU law, however, they cannot be lifted by national authorities as things stand. To enable them to do so, provisions permitting experimentation would first have to be inserted into EU legislation.

Ultimately, a European sandbox should be created allowing an institution such as the ECB, for example, to promote certain innovations centrally for the entire euro area.

In addition, there needs to be close coordination within the network of sandboxes to ensure a level playing field.
6. Align tax bases

I. What problem, what obstacles need to be overcome?

Full harmonisation of business taxation (i.e. of direct taxes such as corporation tax, income tax, etc.) is not possible in the absence of a mandate for the EU. Certain particularly serious tax obstacles to cross-border business activities, especially of banks, should nevertheless be addressed and eliminated.

Obstacles in the area of business taxation basically exist because companies, especially banks, are currently confronted with 27 different tax regimes in the EU, which gives rise to numerous problems when trying to determine national tax assessment bases. There is also an associated risk of double taxation, as well as questions about appropriate transfer pricing and loss offsetting. Tax authorities face high administrative costs and businesses high compliance costs. Competitive distortion in the EU and at international level is inevitable.

Twice in the last 15 years (2006/2011), the European Commission put forward extensive proposals for establishing a standardised, clear and fair way of taxing businesses by introducing a common consolidated corporate tax base (CCCTB). The initiatives were supported by the European Parliament. But ECOFIN failed to reach agreement on the CCCTB.

In light of the tax challenges posed by the digital economy, the European Commission issued a proposal in 2018 aimed at closing tax loopholes that have allowed globally active companies (“GAFA”) to drastically reduce their tax liability and avoid taxes in countries where they make a profit. This proposal is for a two-stage plan. The first stage would create a common corporate tax base (CCTB) and only in the second stage would a common consolidated base be established. In addition, the proposal envisages determining taxable profits on the basis of a “digital” presence and the establishment of a single, “one-stop-shop” tax authority for companies. This new initiative also has the support of the European Parliament. Discussions in ECOFIN are ongoing. In view of parallel efforts by the OECD to find an approach to taxing the digital economy, however, no decision from ECOFIN is expected for the time being.

II. What solution, what objectives are we seeking?

For businesses active across Europe, the influence of taxation on the decision as to where to locate in the EU should be eliminated or at least limited to a comparison of tax rates. Market forces need to be strengthened and a level playing field created for firms, especially in the financial sector, that operate across borders.

With this in mind, we warmly welcome the European Commission’s new initiative with its two-step approach.
Even a CCTB would help significantly to establish better conditions for companies operating across borders in terms of a tax regime in the EU that is fairer, less distorting and more resistant to gaming than is the case under the existing purely national regimes or than could be achieved by purely national measures.

III. What (legal, regulatory, other) changes are needed?

Existing national rules and regulations should be adjusted in line with the European Commission’s 2018 proposal for a CCTB. Room for improvement nevertheless remains in the proposal itself. Action is needed above all in the following areas.

- A reference basis (e.g. EU accounting law, IFRS) is needed given the existing heterogeneity in the EU of the approaches to determining taxable income.
- The proposed technical design is book-to-tax reconciliation rather than an accounting-based solution with balance sheet and profit and loss account, which would be preferable from the perspective of the banking industry.
- Some legal terms are not defined or are not spelled out in sufficient detail (e.g. the definition of the key term “economic asset” or the insufficiently clear method of determining acquisition and production costs).
- The general principles for determining the tax basis with respect to an objectified determination of profits are incomplete and require further fleshing out. No solution is proposed to possible conflicts of objectives resulting from hierarchies of objectives.
- There is no explicit provision for dealing with the impairment of doubtful accounts receivable; the ability to make value adjustments, especially general value adjustments, should not be called into question.
- There are no rules on forming valuation units along the lines of the requirements of Section 5 (1a), sentence 2 of the German Income Tax Act.
- There is a lack of detail in some areas, such as the treatment of derivatives as an element of financial assets in the financial industry, the treatment of leasing and the definition of beneficial owner.
- There are restrictions on the permissibility of unscheduled valuations of assets; the corresponding improved consideration of cross-border losses is not sufficient.
- Rules on the formation of provisions:
  - there are restrictions on legal obligations, meaning that (objectifiable) economic asset charges cannot be taken into account;
  - only accumulated provisions may be built up instead of the full provisioning required from an economic perspective;
  - there is no arrangement permitting the deductibility of “technical” provisions (for general banking risks) with reference to the Banks Accounts Directive (OJ EC of 31.12.86 No. L 372/1; amended in OJ EC of 23.11.88 No. L 316/51) and the Bank Branches Directive (OJ EC 16.02.89 No. L 44/40) or which provides for impairment of financial assets using the expected loss model (based on the IASB’s ED/2009/12 on Financial Instruments).
7. **Call off financial transaction tax**

I. **What problem, what obstacles need to be overcome?**

The introduction of an FTT was originally intended to ensure that those who caused the financial crisis would shoulder some of its costs. On 28 September 2011, the European Commission issued a proposal for a directive envisaging the EU-wide collection of an FTT on as many financial products as possible. No agreement could be reached on the proposal, however. Germany and France therefore proposed introducing the FTT under the enhanced cooperation mechanism requiring the involvement of at least nine member states. Austria, Belgium, Estonia, Greece, Italy, Portugal, Slovakia, Slovenia and Spain also agreed to participate. On 14 February 2013, the European Commission presented a corresponding proposal for a directive. But in all the years of negotiation since then, the participating member states have been unable to reach agreement. What is more, the number of participating states fell from eleven to ten when Estonia left the enhanced cooperation at the end of 2015.

At the end of 2018, with the aim of bringing the project to a conclusion, Germany and France proposed initially taxing only transactions in shares, as has been the case in France since August 2012. This FTT would be levied only on shares of financially strong listed companies located in participating member states. Member states that would receive little or no revenue from the FTT since they are home to few or no companies meeting the criteria (Greece, Slovakia and Slovenia) would be paid a guaranteed minimum amount of €20 million. These sums would come from countries whose own FTT revenues exceeded €100 million; in addition to Germany, this would include France, Spain, Italy and Belgium.

In December 2019, Germany, in consultation with France and Italy, submitted a corresponding proposal for a directive on the introduction of an FTT on shares and a procedure for allocating the resulting revenue among the member states participating in the enhanced cooperation.

An FTT in the form of a tax on shares cannot even begin to meet the objectives pursued by its advocates, however. As explained above, the FTT was originally intended to make banks shoulder some of the burden of the financial crisis. But the FTT will not hit “those responsible” for the crisis but the entire economy from businesses to small investors. The introduction of an FTT on shares would therefore send out the wrong signal. It would act as a further blow to private investment in an extremely tense negative interest rate environment. It would undermine policymakers’ calls for greater private provision for old age. But it would also make it more difficult for listed companies to raise capital by issuing shares, place capital markets in the EU at a disadvantage, distort competition and encourage the migration of business to financial markets without the FTT. In short, an FTT would torpedo the creation of EU-wide capital markets union.

Austria – until now a strong supporter of an FTT – announced in December 2019 that it would not support the current proposal for a tax only on shares.
II. What solution, what objectives are we seeking?

The planned FTT would pose incalculable risks for the stability of the financial markets and the economy as a whole in participating member states. Its far-reaching negative consequences have evidently been totally underestimated. The project should be abandoned once and for all.
8. Review VAT on financial services

I. What problem, what obstacles need to be overcome?

Since banks mainly provide tax-exempt services, which means there can be no deduction of input VAT, VAT does not have a neutral effect on banks, thus violating the principle of the neutrality of VAT. The non-deductible input tax on services received thus imposes a definitive cost burden on the banking industry. This “hidden” VAT often frustrates the development of efficient and economically sound business structures that are indispensable for ensuring the competitiveness of the European banking industry in global financial markets.

There is also a lack of legal certainty in the absence of a definition of precisely what is meant by financial services. The list of tax-exempt financial services in the VAT Directive, which is the legal basis for national legislation on VAT, is too narrow and no longer reflects the prevailing circumstances. The financial services sector has been subject to constant change since the introduction of the directive in May 1977 and, given the pace of digitalisation, this change is set to continue. The directive’s requirements concerning tax exemption for financial services have yet to be fundamentally updated, however. Many issues have to be clarified by the Court of Justice of the European Union (CJEU). Some relevant CJEU case law which is still being applied is more than 20 years old and no longer fit for purpose today.

On top of that, member states interpret EU requirements and CJEU case law differently, which leads to competitive distortion within the EU. At international level, too, European banks are at a competitive disadvantage compared to banks in countries with more advantageous VAT regimes for financial services (e.g. zero tax rate with full input tax deduction in New Zealand, no VAT on financial services in the United States).

As early as on 28 November 2007, the European Commission therefore presented proposals for modernising VAT on financial services. These were discussed by member states until the end of 2011. Since no agreement could be reached and no longer looked likely, the Commission withdrew the proposals in April 2016. But the problems associated with VAT on financial services have not gone away, especially the lack of legal certainty and of VAT neutrality for banks.

II. What solution, what objectives are we seeking?

For European banks to remain competitive in the face of the increasing internationalisation and globalisation of financial markets, they have to be able to put cost-effective business structures in place without incurring an additional VAT burden that will totally negate the desired synergy effects. It is also important to take account of the growing digitalisation, which is now creating additional VAT problems. It is essential to ensure that different providers of financial services (e.g. banks and fintechs) are treated equally with respect to VAT to avoid distorting competition within the financial services industry.
Against this backdrop, we warmly welcome the fact that in June 2019 the European Commission commissioned a review of VAT rules for financial and insurance services. The review is scheduled for completion in July 2020.

III. What (legal, regulatory, other) changes are needed?

The existing VAT regime for financial services needs to be overhauled and updated to reflect today’s realities. Legal certainty and the neutrality of VAT for the banking industry need to be improved, obstacles to economically efficient business models removed and all distortion of competition avoided so as to strengthen the competitiveness of the European banking industry in the international arena and create a level playing field within the EU as well.