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THE EUROPEAN UNION**

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**COVER NOTE**

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from: Mr Xavier MUSCA, President of the Economic and Financial Committee  
date of receipt: 18 December 2006  
to: Mr Eero HEINÄLUOMA, President of the Council of the European Union  
(ECOFIN)  
Subject: 2006 EFC Report to the Commission and the Council on the Movement of  
Capital and the Freedom of Payments

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Dear Mr President,

Under Article 114 (2) of the EC Treaty, the Economic and Financial Committee (EFC) is mandated, amongst other things, to:

*"examine, at least once a year, the situation regarding the movement of capital and the freedom of payments, as they result from the application of this Treaty and of measures adopted by the Council; the examination shall cover all measures relating to capital movements and payments; the Committee shall report to the Commission and to the Council on the outcome of this examination."*

I hereby provide you with the annual report of 2006. As in the past, the report reviews the state of affairs with respect to possible infringements; the commitments undertaken by the candidate countries; and action taken in the fight against terrorist financing and money laundering. On the whole, positive global economic and financial conditions have resulted in a rise in overall investments, in particular direct investments in the form of mergers and acquisitions - with differences across sectors and individual Member States. While the EU's position in capital markets has continued to improve as financial integration in the Community proceeds, further efforts will be needed to maintain open and competitive capital markets. Therefore, actions to promote to capital movements and freedom of payments within the EU as well as coherent policy towards third countries and relevant international bodies should be reinforced.

As previously, the EFC is grateful for the high quality assessments prepared by the Commission which greatly benefited the work.

I have also written in similar terms to the President of the European Commission.

(Complimentary close)

Xavier Musca

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Encl.:



Brussels, 15 November 2006

ECFIN/CEFCPE(2006)REP/56882

**Annual EFC Report to the Commission and the Council  
on the Movement of Capital and the Freedom of Payments**

1. Under Article 114(2) of the EC Treaty, the Economic and Financial Committee (EFC) is called upon

*"to examine, at least once a year, the situation regarding the movement of capital and the freedom of payments, as they result from the application of this Treaty and of measures adopted by the Council; the examination shall cover all measures relating to capital movements and payments; the Committee shall report to the Commission and to the Council on the outcome of this examination."*

2. In its eighth report, the EFC assesses developments with respect to capital movements and the freedom of payments, considering, developments inside and outside of the Community, based on the Commission's examination, particularly with respect to possible infringements; developments in mergers and acquisitions; and ongoing action in the fight against terrorist financing and in money laundering.

**I. General remarks**

3. The EFC notes that positive global economic and financial conditions have continued to favour cross-border investments, within the Union as well as in its relations with third countries. This has resulted in a rise in overall investments, in particular direct investments in the form of mergers and acquisitions. In this context, the EFC takes note of the differences across sectors and individual Member States due to exceptionally large restructuring efforts, and continuation of sizable investment from euro area to the recently acceded Member States.

4. While the increased cross-border capital movements has taken place within the internal market, the EFC takes note of the difficulties arisen in a few cross-border mergers and acquisitions in some sectors only recently open to competition. In the global context, the current situation with the Doha Round could signal a decreasing emphasis on multilateral, and a growing interest in bilateral, investment liberalisation. Furthermore, large developed countries, among them the US, are revisiting their defences against foreign take-overs.

5. In this context, the EFC stresses the importance of maintaining open and competitive capital markets, including by the efficient enforcement of Treaty and Internal Market rules within the EU; and the need to monitor the state of affairs with respect to external investment relationships with the global partners and, related to this, the need to stand ready to review the Community approach where necessary. The EFC also reaffirms the need for an orderly liberalization of capital movements in the candidate countries and attaches great importance to the monitoring process on this subject; as well as the need to continue the fight against terrorist financing and money laundering.

## **II. Capital movements and the freedom of payments within the EU**

### ***II. 1 Infringement procedures***

6. The EFC welcomes the changes introduced by the Commission since 2005 in its enforcement of Internal Market rules concerning capital markets, including by prioritization of infringement procedures aimed at identifying the cases requiring the most rapid action; and the use of a wider selection of enforcement tools in removing the identified obstacle to capital movements, in particular the competition policy instruments.

7. On the infringement procedures since the 2005 report, **eight cases were closed** or not proceeded with, and **twelve cases were opened** or may be opened. **Three** cases were closed following successful discussion with the Member States, which accepted to amend their incriminated provisions in a satisfactory way. These cases related to a bilateral investment treaty (BIT), to government authorisation procedures in privatised companies and to restrictions on investment in the energy sector by companies with state participation. Of the **eleven** new or potential cases, one followed a complaint and **ten** were on the initiative of the services. Complaints generally concern various issues, which are often of relatively minor importance in terms of the internal market in broad terms, and it is uncertain whether they will be pursued further.

8. The EFC notes that a total of **thirty eight** cases are currently open as follows:

- twenty two open cases relate to special rights that governments maintain in some companies;
- three cases concern bilateral investment treaties;
- one relates to real estate; and
- The other cases relate to various specific issues (such as, access to the stock exchange and authorisation procedure for foreign investment).

9. The EFC also takes note that since last review, the European Court of Justice delivered its ruling in two cases<sup>1</sup>, whereas five other cases<sup>2</sup> are still pending before the European Court of Justice (ECJ). Moreover, in a number of ongoing cases, while infringement procedures are still open, there has often been a quality improvement in underlying legislation and the obstacles to capital movement have been partly removed, but frequently not sufficiently so for the Commission to pass on its duty of pointing to possible conflicts with Treaty provisions. Several preliminary ruling cases<sup>3</sup> regard the **third country dimension**<sup>4</sup> and can be expected to clarify the relationship between the free movement of capital and the other Treaty freedoms. In the area of **direct taxation**, the ECJ has delivered its judgement regarding the setting off cross-border losses incurred by foreign subsidiaries<sup>5</sup>.

## *II.2 Actions to promote capital movements*

10. The EFC takes note that restrictions on intra-EU investment continue to exist in specific areas, as indicated by the Commission's examination. It calls for further efforts to complete the Internal Market and enhance cross-border integration and consolidation; and urges Member States to cooperate in abolishing the restrictions identified.

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<sup>1</sup> Special rights attributed to the Dutch State by the Articles of Association of KPN and TNT Post Groep C-282/04 and C-283/04 (NL) on 28 September 2006

<sup>2</sup> the Volkswagen law in Germany, the liquidity reserves rules for cooperative banks in Austria, the special rights in privatised companies in Italy, and two cases (Austria and Sweden) on bilateral investment agreements

<sup>3</sup> e.g. Fidium Finanz, case C-452/04, Lasertec, case C-492/04 (the third country equivalent of the Lankhorst-Hohorst case, C-324/00), Skatteverket v A, case C-101/05, Skatteverket v A and B, case C-102/05, and Holböck, case C-157/05.

<sup>4</sup> Article 56 EC

<sup>5</sup> *Marks and Spencer Plc (M&S)* case (C-446/03) on 13 December 2005,

11. The EFC stresses that, taking into account the persistence of the trends identified in the 2005 report and close links between financial integration and the movement of capital, cross-border establishment of financial institutions and cross-border trade in financial services must be enhanced. In that context, the EFC recalls the approach by the Commission to promote capital movements in the context of the **White Paper for Financial Services Policy (2005-2010)**<sup>6</sup> in line with the ECOFIN conclusions of May 2006; and especially stresses the importance of the following actions towards 2007:

- First, the need to address the regulatory obstacles for cross-border acquisitions of financial institutions also by ensuring consistency across financial sectors by **amending the regulatory framework** for the prudential assessment of acquisitions or increases of qualifying shareholdings in financial institutions in line with the ECOFIN Council conclusions of 8 November 2005<sup>7</sup>;
- Second, ensuring efficient and sound **post-trading services in securities markets** in line with the 5 May 2006 ECOFIN Council conclusions and in the light of the potentially sizeable benefits as examined by the Commission<sup>8</sup>, by ensuring the implementation of the Code of Conduct signed on 7 November 2006 by the industry; monitoring of competition policy aspects; removal of the so called Giovannini barriers; by ensuring the necessary regulatory and supervisory framework for these infrastructures, especially by an expeditious adoption of those ESCB-CESR standards where agreements has been reached. The EFC also takes note that the Eurosystem is examining, before its possible implementation, potential benefits of TARGET2-Securities and its possible contribution to ensuring efficient and sound post-trading services in the EU securities markets.
- Third, establishing a **single payments market** in Europe in line with the 10 October 2006 ECOFIN conclusions by Single-Euro-Payments-Area (SEPA) initiative and a sufficient regulatory framework<sup>9</sup>;

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<sup>6</sup> The Commission released the White Paper on 5 December 2005. Council gave its conclusions on 5 May 2006.

<sup>7</sup> Commission put forward a proposal on 12 September 2006.

<sup>8</sup> Commission released its examination in May 2006.

<sup>9</sup> On 1 December 2005, the Commission released a proposal for a Directive on Payment Services in the Internal Market.

- Fourth, by ensuring that efficient **EU arrangements for financial stability** are in place, and that the Recommendations by the Financial Services Committee on financial supervision are fully implemented; and
- Fifth, the Commission's forthcoming **White paper on asset management**<sup>10</sup> to be aimed at enhancing the EU-framework for collective investments in the light of broadening the possibilities to invest in a range of funds across the EU – in particular private equity funds and hedge funds.

12. The EFC invites the Financial Services Committee to monitor the progress in the above mentioned areas and provide further advice to the Council and Commission in the 2007; looks forward to the forthcoming Internal Market Review by the Commission; and invites the Commission to review the progress in cross-border consolidation in the financial sector and its impacts by 2008.

13. Overall, in the light of the global nature of the capital flows, the EFC notes that the global dimension integration must be sufficiently taken into account. In this context, the Commission, together with the Member States and relevant Committees as appropriate, is invited to continue its proactive approach towards standard setting bodies; third countries in the context of the European Neighbourhood Policy; in the negotiations on new agreements or the regulatory dialogues with 3<sup>rd</sup> countries, in particular the US, Japan, China and India.

### **III. External dimension of capital movements and the freedom of payments**

#### ***III.1 The Candidate Countries***

14. The EFC takes note of the assessment by the Commission in its Monitoring Reports of May and September 2006 on Romania and Bulgaria on the preparedness for EU membership, and particularly welcomes the progress made in these countries in the area of money laundering. In this context the EFC stresses the need to set up a mechanism for cooperation and verification of progress in the areas of judicial reforms, fight against corruption and organised crime.

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<sup>10</sup> Green Paper on the enhancement of the EU framework for investment funds 14 July 2005. White Paper on Enhancing the Single Market Framework for Investment Funds was released on 15 November 2006.



15. Following the launch of the accession negotiations with Croatia and Turkey in 3 October 2005, the screening process concerning the analytical examination of the Community acquis with these two candidate countries started on 20 October 2005. On 8 November 2006, the Commission adopted the progress reports 2006 for these countries. In line with this, the EFC notes that Croatia made some progress on the free movement of capital, but further efforts are needed, especially as regards money laundering and procedures for acquisition of real estate by EU nationals<sup>11</sup>. Turkey made very little progress on the free movement of capital, and alignment remains incomplete in particular concerning the fight against money laundering, acquisition of real estate by foreigners remains restricted<sup>12</sup>. On 17 December 2005, European Council granted the statute of candidate country also to the Former Yugoslav Republic of Macedonia (FYROM) and in this context, the Commission was invited to report on future progress. Further monitoring of capital movements of these countries will be necessary as the process proceeds.

### ***III.2 The Bilateral Investment Treaties within the EU***

16. The EFC takes note that there are currently around 150 Bilateral Investment Treaties (BIT) still in force between the EU Member States, while part of their content has been superseded by Community law upon accession. In order to avoid legal uncertainties and unnecessary risks for Member States in the unclear situation, Member States are invited to review the need for such BITs agreements; and inform the Commission about the actions taken in this context so that progress can be reviewed by the EFC by the end of 2007.

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<sup>11</sup> COM(2006)649

<sup>12</sup> COM(2006)649

### ***III.3 Issues relating to developed countries***

17. With respect to the **United States**, the EU-US summit on 21 June 2006 highlighted the importance to keep investment regimes mutually open, to build on existing investment flows and to reduce remaining obstacles in order to boost growth and create jobs. Within the Economic Initiative<sup>13</sup>, regulatory and standards cooperation was enhanced. The EFC takes note that there is an ongoing issue about state interference with acquisitions of US companies by foreign enterprises, due to concerns of national security, occasioning close monitoring by the Community<sup>14</sup>.

18. The EFC also regrets that the **WTO** Doha negotiation round suspended in July 2006 and that it remains unclear whether and when the process might continue. In this context, a general review of the Community strategy as concerns negotiating trade and investment agreements, in particular with developing countries, may be necessary. The EFC stresses the importance of achieving an ambitious outcome on the Doha Development Agenda, that this remains the EU's first priority, and that the EU will work intensively to restart the negotiations as soon as possible.

### **IV. Strengthening the fight against terrorist financing and money laundering**

19. The EFC reaffirms the importance of efforts to continue addressing the financing mechanisms of terrorism and preventing and countering money laundering and financial crime, and in this context notes the following:

- The **EU Action Plan to combat terrorism** was revised in February 2006<sup>15</sup> and a European Council report on progress made with the plan was published in May 2006<sup>16</sup>;

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<sup>13</sup> Following a commitment at the 2004 summit

<sup>14</sup> There are intentions in Congress to tighten the existing Exon-Florio provisions for screening foreign direct investments, in particular as concerns a strengthened investigation of investments by foreign companies with state participation.

<sup>15</sup> <http://register.consilium.europa.eu/pdf/en/06/st05/st05771-re01.en06.pdf>

<sup>16</sup> <http://register.consilium.europa.eu/pdf/en/06/st09/st09589.en06.pdf>

- The **EU-Counter-Terrorism Strategy**<sup>17</sup> adopted by the European Council in December 2005 aims at combating terrorism globally while respecting human rights and making Europe safer, allowing its citizens to live in an area of freedom, security and justice. Apart from provisions for freezing terrorist assets, the strategy puts emphasis on the implementation of EU-wide legislation concerning money laundering and cash transfers and on the agreement of steps to impede money (wire) transfers by terrorists. In addition, tackling the misuse of the non-profit sectors remains a priority. A review of the EU's overall performance against terrorist financing is also conducted. The results of that independent scrutiny are expected before the end of 2006.
- The **Third Money Laundering Directive**<sup>18</sup> was adopted in October 2005 and technical implementing measures<sup>19</sup> were adopted in July 2006. The Directive should be implemented at the latest in December 2007.
- The Regulation on controls of cash entering or leaving the Community<sup>20</sup> provides for a Community wide approach to controlling cash movements (equal or more than €10.000) into or out of the Community. This regulation shall apply from June 2007 onwards.
- Following a proposal for a Regulation on information on the payer accompanying transfers of funds<sup>21</sup> by the Commission in July 2005, the Council in December 2005 agreed on the general approach set out in the proposal and on the opening of negotiations with the European Parliament. The Regulation is expected to be adopted before the end of 2006.
- In the area of coordination between Member States, further progress has been made in the development of FIU-NET, the EU network aimed at linking up the Financial Intelligence Units of the Member States through a real time information exchange system; and
- Dialogue with the US and other third countries on combating the financing of terrorism has been continued with an aim to make sanctions more effective.

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<sup>17</sup> See web-site [http://ue.eu.int/ueDocs/cms\\_Data/docs/pressData/en/jha/87257.pdf](http://ue.eu.int/ueDocs/cms_Data/docs/pressData/en/jha/87257.pdf)

<sup>18</sup> Directive 2005/60/EC of 26 October 2005, OJ L309 of 25/11/2005

<sup>19</sup> See web-site [http://ec.europa.eu/internal\\_market/company/financial-crime/index\\_en.htm](http://ec.europa.eu/internal_market/company/financial-crime/index_en.htm)

<sup>20</sup> Regulation (EC) No1889/2005 of 26 October 2005, OJ L309 of 25/11/2005

<sup>21</sup> COM(2005)343 of 26 July 2005



## V. Financial sanctions

20. The EFC notes that financial sanctions, which concern mainly the freezing of funds and economic resources, remain in force, subject to some amendments, broadly in line with the 2005 report. The following additional actions have been taken since November 2005:

- In February 2006, a Regulation targeting persons suspected of involvement in the assassination of former Prime Minister of the Lebanon, Rafiq Hariri; and
- In May 2006, a Regulation targeting persons who were responsible for the violations of international electoral standards in the Presidential elections in Belarus and the crackdown on civil society and democratic opposition, as well as natural or legal persons, entities or bodies associated with them.

21. Finally, the EFC welcomes that on the **EU asset freezing procedures** the Best Practices paper for effective implementation of restrictive measures has been reviewed in December 2005; and an electronic **Consolidated list** of persons, groups and entities subject to EU financial sanctions<sup>22</sup> is regularly being updated to assist the members of the EU Credit Sector Federations in their compliance with financial sanctions and should make the freezing of bank accounts more effective.

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<sup>22</sup> see website [http://europa.eu.int/comm/external\\_relations/cfsp/sanctions/list/consol-list.htm](http://europa.eu.int/comm/external_relations/cfsp/sanctions/list/consol-list.htm)