Brussels, 13 May 2011

BACKGROUND[1]

ECONOMIC and FINANCIAL AFFAIRS COUNCIL

Tuesday 17 May in Brussels

Proceedings will begin on Monday 16 May, at 13.30, with an informal dialogue between representatives of the Council and the European Parliament, focusing on economic governance.

This will be followed by ministerial meetings on the ***European Stability Mechanism****, at 15.00, and on assistance for Portugal, at 17.00, and a meeting of the* ***Euro Group****, starting at 18.30.*

Over breakfast on Tuesday, starting at 8.30, ministers will meet in their capacity as governors of the European Investment Bank for the annual ***EIB governors' meeting****.*

Starting at 11.00, the Council is expected to take a decision on the granting of financial assistance to ***Portugal****, setting out the conditions for granting that assistance.*

The Council will take stock of negotiations with the European Parliament on legislative proposals dealing with ***economic governance****. And it will be called on to approve a draft regulation on* ***short selling*** *and credit default swaps.*

The ***taxation of savings income*** *is amongst the other items on the Council's agenda.*

Over lunch, ministers will meet their counterparts from the candidate countries – Turkey, Croatia, the former Yugoslav Republic of Macedonia, Montenegro and Iceland – to discuss their economic policies.

Press conferences:

- after the Euro Group meeting *(Monday evening)*;
- at the end of the Council *(Tuesday).*

Press conferences and public events by video streaming: **http://video.consilium.europa.eu/**

Video coverage for preview and download in broadcast quality (MPEG4): **http://tvnewsroom.consilium.europa.eu**

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[1] This note has been drawn up under the responsibility of the press office

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Economic governance

The presidency will present a report on progress in negotiations with the European Parliament on a package of legislative proposals on economic governance. The Council will be called on to provide guidance on certain issues.

The proposals set out to strengthen economic governance in the EU – and more specifically within the euro area – as part of the EU's response to the challenges highlighted by recent turmoil on sovereign debt markets.

The Council reached agreement on a general approach on 15 March, opening the way for the negotiations with the Parliament. Its objective is for an overall agreement to be reached next month, as called for repeatedly by the European Council.

The proposals are aimed at enhancing budgetary discipline in the member states and broadening the surveillance of their economic policies, thus implementing the recommendations of a task force chaired by the President of the European Council, Herman Van Rompuy[2].

The package consists of:

- a draft regulation amending regulation 1466/97 on the surveillance and coordination of member states budgetary and economic policies;
- a draft regulation amending regulation 1467/97 on the excessive deficit procedure;
- a draft regulation on the enforcement of budgetary surveillance in the euro area;
- a draft regulation on the prevention and correction of macroeconomic imbalances;
- a draft regulation on enforcement measures to correct excessive macroeconomic imbalances in the euro area;
- a draft directive on requirements for the member states' budgetary frameworks.

Four of the proposals deal with reform of the EU's Stability and Growth Pact, strengthening the surveillance of fiscal policies, introducing provisions on national fiscal frameworks, and applying enforcement measures for non-compliant member states more consistently and at an earlier stage. The other two proposals target macroeconomic imbalances within the EU.

Adoption of four of the six proposals will require agreement with the Parliament. The other two, namely the regulation amending regulation 1467/97 and the directive on budgetary frameworks, are to be adopted by Council alone, after consulting the Parliament.

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[2] Final report of the task force, 21 October 2010: http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ec/117236.pdf

Short selling and credit default swaps

The Council is expected to agree a general approach on a draft regulation on short selling and credit default swaps[3] (6823/3/11 REV 3).

The draft regulation is aimed at harmonising rules for short selling and certain aspects of credit default swaps. It introduces common EU transparency requirements and harmonises the powers that regulators may use in exceptional situations where there is a serious threat to financial stability.

Adoption of a general approach will enable the presidency, on behalf of the Council, to start negotiations with the European Parliament.

At the height of the financial crisis in 2008, several member states adopted emergency measures to restrict or ban short selling in some or all securities in order to counter a downward spiral in the prices of shares that could create systemic risks.

As the EU lacks a common regulatory framework for dealing with short selling, member states adopted divergent measures. The current fragmented approach limits the effectiveness of the adopted measures and results in regulatory arbitrage[4]. It may also create confusion in the markets and impose additional costs on market participants.

The draft regulation is intended to address these issues, whilst acknowleging the role of short selling in ensuring the proper functioning of financial markets, in particular in providing liquidity and contributing to efficient pricing.

The proposal covers all types of financial instruments but provides for a response proportionate to the potential risks posed by short selling of different instruments. In particular, for shares of companies listed in the EU, it creates a two-tier model for transparency of significant net short positions: While at a lower threshold, notification of a position must be made privately to the regulator, at a higher threshold, positions must be disclosed to the market.

For sovereign debt, on the other hand, significant net short positions relating to issuers in the EU would always require private disclosure to regulators. The proposed regime also provides for notification of significant positions in credit default swaps that relate to EU sovereign debt issuers.

To tackle the increased risks posed by uncovered short sales[5], the proposal requires that anyone entering into a short sale must at the time of the sale have borrowed the instruments, entered into an agreement to borrow them or made other arrangements to ensure they can be borrowed in time to settle the deal.

However, these restrictions don't apply to the short selling of sovereign debt if the transaction serves to hedge a long position in debt instruments of an issuer. Moreover, if the liquidity of sovereign debt falls below a specified threshold, the restrictions on uncovered short selling may be temporarily suspended by the relevant competent authority.

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[3] The short selling of securities is a practice whereby an investor sells a security he doesn't own with the intention of buying it back when the price has fallen.
A credit default swap is a financial instrument with the characteristics of an insurance, guaranteeing the creditworthiness of a loan.

[4] i.e. where investors exploit differences between regulatory systems.

[5] "Uncovered" or "naked" short selling is a practice where the seller has not made arrangements to borrow the security.

In exceptional situations that threaten financial stability or market confidence in a member state or the EU, the draft regulation provides that competent authorities should have temporary powers to require further transparency or to impose restrictions on short selling and credit default swap transactions or to limit individuals from entering into derivative transactions.

In such a situation, the European Securities Market Authority (ESMA) is given a co-ordination role to ensure consistency between competent authorities and to guarantee that such measures are only taken where it is necessary and proportionate to do so. ESMA is also given the power to take measures where the situation has cross-border implications.

The intervention powers of ESMA would be based on article 9(5) of the regulation establishing ESMA, which authorises the agency to "temporarily prohibit or restrict certain financial activities that threaten the orderly functioning and integrity of financial markets." However, when it comes to short selling of sovereign debt instruments, ESMA would only be authorised to intervene after it has received the consent of the relevant competent authorities.

Based on article 114 of the Treaty on the Functioning of the European Union, the regulation requires a qualified majority for adoption by the Council, in agreement with the Parliament. No formal vote is however required for a general approach.

Taxation of savings income

The Council will hold a policy debate on a draft directive aimed at strengthening the provisions of directive 2003/48/EC on the taxation of savings income. It will be called on to adopt conclusions calling for negotiations to be started with five non-EU European countries to update current agreements on the taxation of savings income.

The proposed amendments to directive 2003/48/EC are intended to avoid its circumvention by reflecting changes to savings products and developments in investor behaviour since it was first applied in 2005.

They enlarge the directive's scope to include not only interest payments but all savings income, as well as products that generate interest or equivalent income (see below).

Two issues have however held up progress on the proposal since it was submitted by the Commission in 2008:

- external conditionality. Two delegations want the directive to apply in its amended form only if the same or equivalent measures are applied by Andorra, Liechtenstein, Monaco, San Marino, Switzerland and ten dependent and associated territories of the Netherlands and the United Kingdom (see detail on the current directive, described below);
- transitional period. Two delegations want their transitional arrangements under the directive (see below) to be maintained until Switzerland agrees to provide tax information automatically. They fear that anti-fraud agreements with Andorra, Liechtenstein, Monaco, San Marino and Switzerland will create the required conditions for ending those transitional arrangements; this would oblige them to exchange information automatically with other member states, whereas their (mainly Swiss) competitors would only be required to provide tax information on request.

In order to overcome these difficulties, the presidency proposes that the transitional period be treated for the moment as a separate issue and addressed at a later stage. It also proposes to deal with the anti-fraud agreements (draft agreement with Liechtenstein, mandate for negotiations with Andorra, Monaco, San Marino and Switzerland) separately from discussions on the savings tax directive.

As regards external conditionality, the presidency proposes to ask the Commission to start negotiations with Andorra, Liechtenstein, Monaco, San Marino and Switzerland with the aim of ensuring that they apply measures that are equivalent to the savings tax directive in its amended form. This was already done when the existing savings tax directive entered into force in 2005, under savings tax agreements with the five countries.

And the presidency proposes that the latest version of the draft directive be considered as agreed for the purposes of those negotiations. (This would however not prevent the directive from being finalised at a later stage.)

At the same time, the Commission is preparing a report assessing implementation of the existing directive.

The presidency's approach is welcomed by delegations as a pragmatic way forward. One delegation, however, considers that further improvements to the draft directive could be necessary in the light of the Commission's report on implementation of the current directive. Another delegation maintains a general reservation.

At present, directive 2003/48/EC requires the member states to exchange information so as to enable interest payments made in one member state to residents of other member states to be taxed in accordance with the laws of the state of tax residence.

For a transitional period, it allows Luxembourg and Austria to instead impose a withholding tax on interest paid to savers resident in other member states.

The transitional period will end when Andorra, Liechtenstein, Monaco, San Marino, Switzerland and the United States are committed to the exchange of information upon request as defined in a 2002 OECD model agreement.

The directive applies only to individual savers and not to companies. It currently covers the taxation of savings income in the form of interest payments, including income from deposit accounts, government securities and corporate bonds, as well as collective undertakings that invest more than 25 % of their assets in debt securities.

Equivalent measures to those provided for in the directive are applied by Andorra, Liechtenstein, Monaco, San Marino and Switzerland, under agreements concluded with the EU, and in ten dependent and associated territories of the Netherlands and the United Kingdom (Guernsey, Jersey, the Isle of Man and seven Caribbean territories), under bilateral agreements concluded with each of the member states.

The proposed draft extends the scope of the directive to cover:
- all savings income and products that generate interest or equivalent income, including agreed return securities, undertakings for collective investment in transferable securities (UCITS) and life insurance contracts that can be directly compared to UCITS;
- certain entities situated outside the EU, such as trusts, foundations and investment companies, which receive income for the benefit of individuals resident in a member state;
- intermediate structures that are not taxed (such as certain types of trusts and partnerships) and which, as "paying agent upon receipt", would be required to apply the directive to the receipt of interest payments from any upstream economic operator, whether or not established in the EU, as long as the beneficial owner is an individual resident in an EU member state.

The draft directive is based on article 115 of the Treaty on the Functioning of the European Union, requiring unanimity for adoption by the Council, after consulting the European Parliament.

Financial sector taxation

The Council will take note of a report from the presidency on the taxation of financial institutions and a report from the Economic and Financial Committee on bank levies (*9918/11*). It is expected to ask the Commission to present before the summer an impact assessment on various options of financial sector taxation.

Levies and taxes are amongst the measures being examined as part of a new crisis resolution framework for the financial industry. They could also help ensure that the industry makes a fair contribution to the consolidation of public finances, thus relieving the pressure on taxpayers.

At both G-20 and EU levels, it has been agreed that should a financial crisis occur in the future, taxpayers' money should not again be used to cover bank losses.

At its meeting in June 2010, the European Council agreed that the member states should introduce systems of levies and taxes on financial institutions; it asked the Council and the Commission to take work forward and to report back in October. The European Council meeting in March 2011 recalled its previous conclusions and called for further work on the introduction of a global financial transaction tax.

Financial sector taxation

The report on financial sector taxation assesses two options, a financial transactions tax and a financial activities tax (see below), and examines possible risks associated with each, in the light of the difficulties the sector is currently facing. It points out that any taxation should be neutral and that the sector should not be overburdened. It reiterates delegations' request to further clarify the purpose of such a tax, which could be aimed at serving as a source of revenue, a financial sector contribution to the costs entailed by the financial crisis, a way of curtailing risky financial activities or a means of heading off future financial crises. The report recalls delegations' appeal to curtail the risk of relocation to financial centres outside the EU, and suggests that the impact of financial sector taxation on tax havens and tax evasion be examined further.

The two options being explored are:

- a financial transactions tax, i.e. a tax that would be levied on all, or the most risky, financial transactions. Interest in this idea, proposed in 1972 by economist James Tobin as a tax on currency transactions, has re-emerged in the wake of the financial crisis, both in the EU and elsewhere;
- a financial activities tax, as suggested recently by the IMF in a report to the G-20. It is a tax that would be applied on the sum of profits and remuneration of financial institutions. Some member states already impose similar taxes, given that the financial industry is largely exempt of value-added taxation.

Bank levies

The report on bank levies provides a state of play on the introduction by member states of systems of levies and taxes. It assesses short-term issues resulting from their implementation, in particular spill-over effects and the double charging of cross-border financial institutions. According to the report, only few concrete examples of negative spill-over effects have been reported so far. Ten member states have already introduced systems of levies and taxes, with four more currently in the process of doing so. The report notes that most levies are being introduced with a certain flexibility towards an EU-wide solution at a later stage.

In June 2010, the European Council agreed that bank levies or taxes should be part of a credible resolution framework. In a communication presented in May 2010[6], the Commission suggested that general principles be agreed on so as to enable a coordinated approach. And it recommended that *ex ante* resolution funds be established – to be financed by a levy on banks – in order to facilitate the resolution of ailing banks as part of a new framework at EU level.

At international level, progress on the issue has proven difficult. At a summit in Toronto in June 2010, the G-20 agreed that the financial industry should contribute towards the costs of resolution; however, whilst acknowledging that some countries are pursuing the option of a financial levy, it noted that other countries are using other approaches.

Whilst there is a growing consensus within the EU regarding the base and scope of bank levies, this is not yet the case as concerns the objective pursued or the question of whether the proceeds should go to member states' general budgets or be channelled into specific crisis resolution funds.

Stress tests in the financial sector - Backstop measures

The Council will be called on to approve a statement providing guidance to member states on the design and communication of backstop measures to support financial institutions revealed to be vulnerable by this year's EU-wide stress test exercise.

Results of the stress tests are expected to be published next month. In March, the European Council called on member states to prepare strategies for the restructuring of vulnerable institutions, including private sector solutions (direct financing from the market or asset sales), and a framework in line with EU state aid rules for the provision of government support in case of need.

Ireland - Review of the economic adjustment programme

The Council is expected to adopt a decision modifying the conditions underpinning financial assistance to Ireland under the European Financial Stability Mechanism (EFSM), with a view to preparing the disbursement of a second instalment of financial assistance.

This follows of a review by the Commission and the IMF, in liaison with the European Central Bank, of progress by Ireland in implementation of its economic adjustment programme, approved last November.

6 Doc. 10394/10

On 28 November, ministers gave the go-ahead for an EUR 85 billion package of financial assistance, following a request submitted by the Irish authorities.

The package includes:

- EUR 10 billion to be used immediately to recapitalise Irish banks, with a EUR 25 billion contingency reserve;
- EUR 50 billion to cover the financing needs of the Irish government's budget.

Half of the banking support measures (EUR 17.5 billion) is financed by Ireland through its treasury cash buffer and investments in its National Pension Reserve Fund. The remainder of the overall package (i.e. EUR 22.5 billion each) is shared equally amongst: (i) the EFSM, (ii) the European Financial Stability Facility, together with bilateral loans from the United Kingdom, Denmark and Sweden, and (iii) the IMF.

The economic adjustment programme was negotiated with the Irish authorities by the Commission and the IMF, in liaison with the ECB. It involves an overhaul of Ireland's banking system, growth-enhancing reforms and the correction of Ireland's excessive deficit by 2015, extending a previous 2014 deadline for reducing its deficit to below 3 % of gross domestic product.

The draft decision is based on regulation 407/2010, allowing for adoption by the Council by qualified majority. It amends decision 2011/77/EU, adopted in December.

Portugal - Financial support

The Council is expected to adopt a decision providing financial assistance to Portugal under the European Financial Stability Mechanism (EFSM), as part of a EUR 78 billion three-year package.

Loans will be provided on the basis of a programme negotiated with the Portuguese authorities by the Commission and the IMF, in liaison with the European Central Bank. The draft decision accordingly includes detailed conditions for granting financial assistance. The EUR 78 billion package will be shared equally by the EFSM, the European Financial Stability Facility and the IMF.

The programme will run from June 2011 to mid-2014. It will involve structural reforms to boost potential growth, create jobs and improve competitiveness, a strategy for consolidation of Portugal's public finances, including the reduction of its deficit below 3 % of gross domestic product by 2013, and efforts to safeguard its financial industry. It includes a banking support scheme of up to EUR 12 billion to provide the necessary capital in the event that market solutions cannot be found.

Portugal's caretaker government announced its intention to seek financial assistance on 7 April, following several months of pressure on sovereign bond markets and political crisis. Portugal has been the subject of the EU's excessive deficit procedure since December 2009, when the Council set out measures to correct its deficit by 2013.

The draft decision is based on regulation 407/2010, allowing for adoption by the Council by qualified majority.

Climate change

The Council is due to adopt conclusions on international measures to combat climate change, focusing on the financial aspects.

The draft conclusions confirm the latest figures on fast-start finance provided for climate mitigation and adaptation measures in developing countries, and assess the prospects for scaled-up financing after 2012.

A United Nations conference on climate change held in Cancún (Mexico) last November and December confirmed support for a step-by-step approach in achieving a global and comprehensive framework for combating climate change after 2012.

The conference took note of commitments made by developed countries in providing new and additional resources for fast-start financing during the 2010-12 period for mitigation and adaptation in developing countries.

It took note of a report from an advisory group that had been established to develop practical proposals on how to scale up long-term financing for climate measures in developing countries. At a UN conference in Copenhagen in December 2009, developed countries committed to a goal of jointly mobilising USD 100 billion annually by 2020.

The Cancún conference also agreed to the establishment of a Green Climate Fund, through which a significant share of multilateral funding will flow, and the setting-up of a committee to design it.

As regards the EU, a report from the Economic Policy Committee indicates that the EU and its member states mobilised EUR 2.34 billion in fast-start finance in 2010 as part of a commitment to provide EUR 7.2 billion over the 2010-12 period (*9888/11*).

Furthermore, the draft conclusions concur with the advisory group's conclusion that it will be "challenging but feasible" to meet the commitment by developed countries to mobilising USD 100 billion by 2020.

EU draft budget for 2012

The Commission will present its draft for the EU's general budget for 2012[7].

The draft provides for payments totalling EUR 132.7 billion (+ 4.9% compared with 2011) and commitments at the level of EUR 147.4 billion (+ 3.7%). The detail is as follows:

APPROPRIATIONS BY HEADING	billion EUR		% change from 2011	
	COMMITMENTS	PAYMENTS	COMMITMENTS	PAYMENTS
1. Sustainable growth:	68.0	57.7	+5.4	+8.3
a) Competitiveness	*15.2*	*12.6*	*+12.6*	*+8.1*
b) Cohesion	*52.8*	*45.1*	*+3.4*	*+8.4*
2. Preservation and management of natural resources:	60.2	57.9	+2.6	+2.8
of which direct aids & market related expenditure	*44.2*	*44.1*	*+3.0*	*+3.1*
of which rural development, environment and fisheries	*15.9*	*13.8*	*+1.5*	*+1.9*
3. Citizenship, freedom, security and justice:	2.0	1.5	(*) +11.0	(*) +3.6
a) Freedom, Security and Justice	*1.3*	*0.9*	*+17.7*	*+6.8*
b) Citizenship	*0.7*	*0.6*	*(*) -0.1*	*(*) -0.3*
4. The EU as a global player	9.0	7.3	+2.9	0.8
5. Administrative expenditure (for all EU institutions):	8.3	8.3	+1.3	+1.4
of which Commission	*3.3*	*3.3*	*0.0*	*0.0*
of which European Council and Council	*0.5*	*0.5*	*-4.4*	*-4.4*
of which European Parliament	1.7	1.7	*+2.3*	*+2.3*
Total appropriations	147.4	132.7	+3.7	+4.9
In % of EU-27 GNI	1.12	1.01		

* excl. EU Solidarity Fund

The Council established its priorities for the 2012 budget in conclusions adopted at its meeting on 15 February (*5895/11*). These will be used by the incoming Polish presidency as a reference in negotiations with the European Parliament and the Commission later in the year.

In its conclusions, the Council acknowledged that fiscal consolidation efforts in the member states would continue to impact the EU's budget in 2012. It highlighted the need to take account of budgetary constraints at the national level whilst continuing implementation of EU programmes and actions, including the financing of actions aimed at tackling the effects of the economic crisis and promoting growth.

The Council is expected to establish its position on the draft budget at the end of July, and the Parliament at the end of October. If their positions diverge, a three-week conciliation process will start on 1 November.

7 http://ec.europa.eu/budget/library/biblio/documents/2012/DB2012/DB2012_docI_pol_pres_en.pdf

Informal meeting in Gödöllö

The Council will take note of the outcome of an informal meeting of EU finance ministers and central bank governors held in Gödöllö (Hungary) on 8 and 9 April.

The following issues were discussed at the meeting: request by Portugal for financial assistance; the economic situation and financial stability in the euro area; economic governance and macroeconomic imbalances; preparation of IMF, World Bank and G-20 meetings; commodity markets; supervision of and developments in the financial industry.

Commodity markets

The Council is expected to adopt conclusions, without discussion, on regulation and supervision in commodity markets and related financial markets.

The draft conclusions were discussed by ministers at an informal meeting in Gödöllö (Hungary) on 8 and 9 April.

Price volatility in all major commodity markets, including energy, metals, minerals, agriculture and food markets, has given rise to concerns about the consequences for the security of supply of such commodities and access for poorer populations, as well as for the global economic outlook. Price volatility also increases the need for well-functioning financial derivatives markets to enable hedging against uncertainties in commodity markets.

While political instability and natural disasters in producer countries have exacerbated price volatility, investment flows into commodity derivatives markets have increased, and work is ongoing at international level so as to better anticipate the consequences.

The draft conclusions, based on a communication from the Commission (*5992/11*) highlight the need to improve the quality and the availability of data, and to improve cooperation between the regulators of financial markets and regulators of commodity markets.

As regards commodity derivatives markets, the text calls for increased transparency, in particular by requiring investors to notify their investment positions to regulators ("position reporting") so as to more effectively prevent market abuses.

The text however refrains from calling for market authorities to be allowed to set position limits on commodity futures markets, pending the outcome of fact finding at international level. Instead, the draft conclusions note the Commission's intention to consider the inclusion of position limits in a forthcoming proposal for a revision of the EU's directive on markets in financial instruments.