



LONDON INVESTMENT BANKING ASSOCIATION
6 Frederick's Place, London, EC2R 8BT
Tel: 020-7796 3606 Fax: 020-7796 4345
Direct: 020-7367 5507 E-mail: ian.harrison@liba.org.uk

21 August 2007

Mr Alexander Wiedow
Director, Indirect Taxation and Tax Administration
Taxation & Customs Union Directorate General
European Commission
B-1049 Brussels

By e-mail to: alexander.wiedow@ec.europa.eu

Dear Mr Wiedow

Review of the VAT Exemption for Financial Services

I am writing on behalf of the London Investment Banking Association (LIBA) to underline the concerns which I expressed orally at the Commission's 31 July stakeholder meeting on the above topic. LIBA, as I am sure you know, is the principal UK Trade Association for investment banks and securities houses: a list of our members is attached. LIBA is also a member of EFSA (the European Forum of Securities Associations), on whose behalf I hold a watching brief in this area.

Firstly, thank you once again for organising this meeting; it was unfortunate that I was unable to stay beyond the first session, but the feedback I have had from those who were there for the full day has confirmed my impression that it was useful and constructive for all involved.

It is however also very clear that there is widespread industry concern, as I and the representatives of several other major trade associations made clear at the beginning of the stakeholder meeting, that the Commission's currently proposed drafts require considerable amendment if they are to satisfactorily meet the pressing need for a major update of the legislation defining the VAT exemption for financial services.

I would stress that we do not see the need for such amendments as a matter of "negotiation" between the Commission and industry stakeholders: we are, as already indicated, in large measure comfortable with the proposed demarcation lines between those services which are within the exemption and those which are not. Our concerns relate rather to the structure and language of the proposed legislation, which we feel does not adequately reflect the way in which today's financial markets actually work, and it is difficult to see how this can be put right without significant further input from industry specialists.

We have seen both the 3 August letter of from the European Banking Federation and the 8 August letter from the British Bankers' Association, and we strongly endorse the comments contained in these two letters. We would like to add three further comments, which are complementary to those set out in the EBF and BBA letters:

- * We are particularly concerned about the wording proposed to deal with derivatives, which we believe to be much too restrictive. The wording in Article 6.4 of the draft Regulation, for example, refers only to options, futures, forward contracts, equity swaps and other total return swaps, and it is not clear that this would cover many of the newer financial instruments which are close relatives of, but not identical with, members of these categories. We consider it essential that the new legislation incorporates a general definition of financial instrument; without such a general approach the VAT status of any new type of derivative is likely to lack clarity, with the potential for further litigation up to ECJ level – precisely the situation which the new legislation is designed to avoid!
- * On a related point, there are an increasing number of products sold by the insurance industry which are economically identical to products sold as derivatives or other forms of financial instrument: catastrophe bonds, weather derivatives and certain types of contract for difference are obvious examples, but there will be many others. Given the fast developing nature of both the insurance and the derivatives markets, it is not practical for EU legislation to specify all the instances where this may happen. It is therefore essential that any new Directive contains wording which ensures that two differently named products sold by different sectors of the financial market which are from an economic standpoint identical should have identical VAT liability¹. Were this not to happen, there would be an incentive for certain types of insurance/derivative business to be re-labelled and marketed by a different element of the financial sector in order to gain the benefit of the exemption, with the potential for artificial distortion of the market.
- * A separate significant concern is the suggestion that global custody services might be excluded from exemption. Global custody is a critical component of trading - being the settlement of transactions, dealing with corporate actions etc. Imposing VAT on the supply of global custody would seriously impact the European market, with negative results for the financial industry and jobs.

At a less important level, I would restate the point which I mentioned to you at the 31 July meeting about the definition of “stock brokering” in Recital 201 of the draft Regulation. While the definition itself is good, the term “stock brokering” has not been used in (at least) the London market for 20 years or more: “securities trading” would probably be the most widely accepted current term. The use of such out-dated language here, and in quite a number of other instances, is not in itself serious, but it does give the impression that new legislation is already well out of date before it becomes law! More seriously, it increases the likelihood that both fiscs and taxpayers will have to continue to go to the ECJ for clarification of the terms used – a situation that can only get worse with time if the legislation is not adequately “future-proofed”. This is

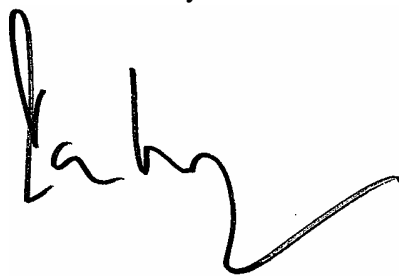
¹ We recognise that this is the approach adopted in much of the current draft, but we are concerned that the present wording may not achieve the required identity of VAT liability in at least some cases.

unfortunate, particularly as it could, we believe, be relatively easily rectified with appropriate industry input.

Given the very tight timetable if a Proposal is to go to Council in November, we recognise that it may be difficult for the Commission to get the new legislation into a wholly satisfactory state by then. It would be a pity if, after all the work which has been done, Member States at that stage share the view of many of us in the industry that the legislation is not yet ready for adoption, and that significant further work needs to be done, but without significant changes to the present drafts that seems a probable outcome. Should that position arise, we would of course remain ready to help the Commission in any way that we can with the necessary further changes to get the legislation to a state where it will meet the modernisation objectives that all concerned – both in the Commission and in the financial services industry - are so keen to achieve.

I hope this is helpful. Please let me know if we can assist in any more practical ways.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ian Harrison', with a long, sweeping tail stroke extending to the right.

Ian Harrison
Director

Copy: Rolf Diemer, European Commission
Burkhard Hein, European Commission
Arthur Kerrigan, European Commission

Quentin Bradshaw, HM Treasury
Roger Kaiser, European Banking Federation
Sarah Wulff-Cochrane, British Bankers' Association

LONDON INVESTMENT BANKING ASSOCIATION

LIST OF MEMBERS

ABN AMRO Bank	HBOS Treasury Services plc
Altium Capital Limited	HSBC Bank plc
Ambrian Partners Limited	ING Bank NV London Branch
Arbuthnot Latham & Co., Limited	Instinet Europe Ltd
Arbuthnot Securities Limited	Investec plc
Arden Partners plc	Jefferies International Limited
Banc of America Securities Limited	JP Morgan Cazenove Ltd
Barclays Capital	J.P. Morgan Securities Ltd
Bayerische Hypo- und Vereinsbank AG	KBC Peel Hunt Ltd
Bear, Stearns International Limited	Kaupthing Singer & Friedlander
BNP Paribas	Lazard & Co., Limited
Brewin Dolphin Securities	Lehman Brothers
Bridgewell Group plc	Libertas Capital Group plc
Calyon	Merrill Lynch Europe PLC
Cantor Fitzgerald Europe	Mizuho International plc
Cenkos Securities Limited	Morgan Stanley & Co. International plc
CIBC World Markets	NCB Stockbrokers Limited
Citigroup Inc.	Noble & Company Limited
Close Brothers Corporate Finance Ltd	Nomura Code Securities Limited
Collins Stewart Europe Limited	Nomura International plc
Credit Suisse Securities (Europe) Ltd	N M Rothschild & Sons Limited
Daiwa Securities SMBC Europe Limited	Numis Securities Limited
Dawnay, Day & Co., Limited	Oriel Securities Limited
Deutsche Bank AG London	Panmure Gordon & Co
Dresdner Kleinwort	PiperJaffray Ltd
Evolution Securities Limited	Sanford C. Bernstein Limited
Fox-Pitt Kelton Limited	Société Générale
Goldman Sachs International	3i Group plc
Greenhill & Co. International LLP	UBS AG London
Hawkpoint Partners Limited	Winterflood Securities Limited

21 August 2007