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CORRIGENDUM
This document corrects document SWD(2020) 39 final of 18.2.2020.
Added the footnote 47.
The text shall read as follows:
“Latvia has made amendments to the Law on Payment Services and Electronic Money in this respect that came into force on 12 November 2019.”

COMMISSION STAFF WORKING DOCUMENT

ON THE MOVEMENT OF CAPITAL AND THE FREEDOM OF PAYMENTS

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This Commission staff working document is for information purposes. It does not represent an official position of the Commission on this issue, nor does it anticipate such a position. It presents these topics in a non-technical format that is accessible to a non-specialist audience.

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1 EXECUTIVE SUMMARY

The free movement of capital is essential for integrated, open and efficient European financial markets that benefit businesses and people in the EU. It is a key element of the European single market. This document reports on capital movements and policy initiatives on the free movement of capital in 2018-2019. It will feed into the Economic and Financial Committee's annual discussions on capital movements and the freedom of payments under Article 134 of the Treaty on the Functioning of the European Union.

The **first** part of this report reviews global and EU capital flows and related economic developments. The **second** part sets out the legal framework, details recent policy initiatives and important challenges, and reviews global initiatives on the free movement of capital and the freedom of payments.

A key takeaway is that in 2018 financial account surpluses and deficits have continued worldwide. This is consistent with their medium-term redistribution away from emerging economies and towards developed economies — an ongoing trend since 2014. Although both the surpluses and the deficits of emerging economies are decreasing, there has been a shift in the distribution of global surpluses away from China and towards oil exporters throughout 2018. This is mainly because of the increase in the price of oil over that same period. Meanwhile, the financial account imbalances of developed economies continue to be polarised between the surpluses of the euro area and Japan and the deficits of the US, the UK, and a group of advanced deficit economies.

From an EU perspective, the main development in 2018 has been the fall in the EU's financial account surplus, driven by a relatively broad-based fall in its Member States' financial accounts' surpluses. Nevertheless, the EU remains the biggest net exporter of capital globally, with a financial account surplus of 2% compared vis-à-vis the rest of the world.

Economic growth and trade tensions weighed on capital flows during 2018, and will likely do the same in 2019. The International Monetary Fund (IMF) has recently revised both the EU and the global growth forecast for 2019 further downward[1] to 0.6 and 0.9 percentage points, respectively, lower than the projections made in April 2018. The moderation of trade flows is also expected to negatively affect capital flows in the future.

The free movement of capital is one of the four fundamental freedoms enshrined in the EU treaties. The **second** part of this staff working document presents how the Commission — the guardian of these treaties — monitors potential barriers arising from Member States' non-compliance with EU law and takes enforcement action if needed.

But there are also national measures or practices that, despite being compatible with EU law, create barriers to the free movement of capital. This can be due to a lack of harmonisation of national rules, the behaviour of private sector actors or structural

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1 'World Economic Outlook' (WEO), IMF, April 2018 and October 2019.

factors. The Commission is working to address these barriers with the Capital Market Union (CMU) whose main objectives include removing any remaining cross-border barriers to capital markets investments in the EU in order to foster investments and create a genuine single market for capital. Although the Commission has delivered all the announced legislative measures, more work is needed to achieve a fully-fledged CMU. A High-level Forum on capital markets was created to engage with market participants, civil society and academics, with a view to proposing targeted policy recommendations for future CMU actions.

The free movement of capital is the only fundamental freedom that is extended to non-EU countries. The Commission promotes it actively on the global stage to ensure a level playing field. It does so by negotiating investment and free trade agreements and participating in international fora such as the OECD (Organisation for Economic Co-operation and Development), which recently revised its code of liberalisation of capital movements.

Although the free movement of capital is necessary to the single market, it also carries risks that cannot be overlooked. Large and volatile capital flows can carry risks for macroeconomic stability. As recent scandals have shown, uncontrolled capital flows can cover up money laundering activities. In the last year, several initiatives were introduced to improve the EU's anti-money laundering framework, including ones that improve supervision and cooperation with law enforcement authorities.

The Commission published several reports on the Member States' implementation of the anti-money laundering framework. These highlighted that risks related to public order and security may arise when foreign investors seek to acquire strategic assets that allow them to access, for example, critical technologies, infrastructure or sensitive information.

In 2019, the EU adopted a screening framework to help all Member States and the Commission identify and effectively mitigate possible risks that certain foreign investments may pose. It will be fully applicable in October 2020.

Capital controls are another tool to prevent possible risks deriving from free movement of capital. These may be necessary to prevent disorderly outflows from causing a financial and economic meltdown. Greece and Iceland applied such controls in recent years. However, Greece has now lifted them all and Iceland lifted most of them in 2019.

The EU may also take restrictive economic and financial measures against non-EU countries, or individuals, groups or non-state entities under its common foreign and security policy. In 2018 and in 2019 two new thematic sanctions regimes were put in place (against chemical weapons and cyberattacks respectively). Current geographical sanctions include, amongst others, measures against Turkey, Nicaragua, Russia and North Korea.

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2 Trends in EU capital flows in the global context, 2018-2019

2.1 Global and EU capital flows[2]

The two main patterns that have shaped the global distribution of net capital flows[3] in recent years continued in the reporting period. First, although capital flows balances remain elevated, their magnitude is smaller compared to the pre-crisis period and they have continued to narrow recently (see Figure 1). Second, relative to the period immediately after the crisis, they have shifted towards advanced economies. Surpluses are mainly concentrated in the euro area and Japan, as the surpluses of China and oil-producing countries (Norway, Russia and Saudi Arabia) have significantly shrunk. At the same time, the distribution of deficits became more concentrated around the US, the UK and some other advanced economies (Australia, Canada and New Zealand) as the deficits in emerging countries, Latin America and elsewhere, declined.

Both patterns continued to play out in 2018: overall surpluses and deficits remained at levels similar to those observed in recent years and their composition did not change substantially.

In 2018, capital continued to be mainly exported from the euro area, Japan, financial centres, oil producers and other surplus countries in Asia, primarily towards the US and, to a lesser extent, to the UK and other large economies, both advanced and emerging. Apart from the euro area and the UK, the non-euro Member States reported — small external positions by world economy standards — surplus for non-euro area (NEA) Nordic economies (Denmark and Sweden) and deficit for the NEA Central and Eastern Europe (CEE).

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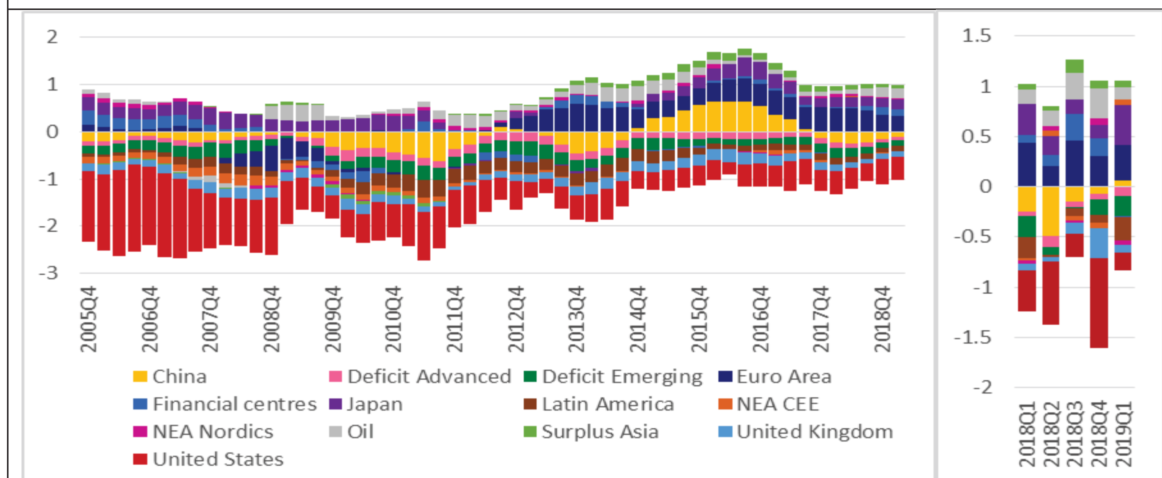
[2] For more details on the latest developments in capital movements, see the study '*Analysis of EU capital flows in the global context*', prepared by Bruegel for the European Commission.

[3] Net flows correspond to the difference between (net) acquisition of assets, often referred to as gross asset flows, and (net) incurrence of liabilities referred to as gross liabilities flows. A positive net flow (i.e. when the flow of acquisition of foreign assets exceeds the flow of incurrence of liabilities to non-residents) therefore translates into net outflows of capital. It is important to note that the underlying 'gross' flows can be negative: a net outflow could therefore be the result of foreign assets being acquired faster than liabilities that are incurred to non-residents, but it could also mean that foreign liabilities are being reduced faster than foreign assets, or that assets increase while liabilities decrease. Equivalently, a negative net flow means an inflow of investment.

Figure 1: Financial account balances, % of world GDP



Source: IMF, International Financial Statistics (IFS) and World Economic Outlook (WEO), April 2019.

Notes: Left-hand side panel shows a 4Q lagged moving average, whereas the right-hand side panel shows the unsmoothed series over the year preceding the last data point available. Both the financial account balance and GDP are measured in USD.

2.2 Foreign direct investments developments

Foreign direct investments (FDI) in net terms[4] tend to flow out of advanced economies towards emerging economies. From a global perspective, while Japan and the euro area are consistent sources of net FDI outflows into the rest of the world, Latin American countries and other emerging economies running current account deficits as well as CEE countries constantly receive flows of direct investment.

Against this backdrop, the first main development in 2018 has been the spike in FDI inflows into the US which until now has traditionally been a source country for FDI flows. Between 2007 and 2014, the US was a major source of net FDI outflows and China was the main destination of net FDI flows. In the aftermath of the 2008 financial crisis, net flows of FDI shrank and, reflecting the double-dip recession in the euro area, shifted away from the euro area towards the US in the case of outflow, and away from non-euro area, CEE towards Latin America in the case of inflow.

Yet, the biggest spike in US FDI inflows took place in 2015. Initially, the US balance swung to inflows while the outflows from the euro area strengthened substantially. The timing of the shift coincided with a wave of US multinationals moving their headquarters to the EU, particularly to euro-area countries. Finally, the 2018 increase in US FDI inflows is partly related to some repatriation of previous earnings from US multinationals after the enactment of the Tax Cuts and Jobs Act (TCJA) from 2017.

The second global shift in capital flow patterns since 2015 relates to China. Net FDI inflows gradually decreased and temporarily reversed into outflows in 2016. This

[4] FDIs in net terms are equal to the difference between the acquisition of gross FDI external assets and the incurrence of gross FDI liabilities.

reversal in FDI was partly linked to the general capital flight out of China, but also to its longer-term economic transition, which is leading to outbound FDI to the rest of the world.

The US and the euro area mainly drove the decline in global gross FDI asset flows in 2018. Traditionally one of the major sources of direct investment worldwide, the US saw a decrease in its FDI asset flows in 2018 for the first time since 2005. Later on in 2019, US FDI asset flows towards the EU recovered and returned to their historical average levels. The euro area's drop in gross FDI asset flows in 2018 was even bigger than the American one and mostly driven by decreases in Luxembourg, Germany and the Netherlands. The drop in CEE countries was driven by the decrease in Hungary, which can be attributed — as is the case in Luxembourg and the Netherlands — to the recent trend of declining flows to and from special purpose entities (SPEs). While the EU as a whole was one of the major sources of FDI globally, the individual economies that were major sources of FDI worldwide in 2018 were Japan, China as well as some global financial centres.

The slowdown in liability accumulation follows the same pattern as the assets, and is largely driven by the euro area, which records negative net accumulation of foreign claims or a reversal of investments previously made by foreigners. In terms of size, the decrease in the US gross liability flows is smaller than the change on the asset side. However, the worldwide decrease in liability flows started somewhat earlier — already in the first half of 2018.

Recently, both intra-EU and extra-EU FDI inflows have been decreasing (see Figure 2). The recent declines in FDI flows seem mostly driven by the slowdown of flows from non-EU ultimate investing country (UIC)s to non-EU ultimate host country (UHC), that pass mainly through SPEs[5]. Another factor thought to have partially influenced the fall in FDI is recent trade tensions. FDI can be closely interrelated with trade as it provides foreign companies with a marketing, financial and physical infrastructure that helps them trade internationally. FDI can also be a substitute to trade, providing a more cost effective way of producing and selling products in a particular country. Pessimism surrounding trade can dis-incentivises these operations, especially as FDI is usually planned in a medium- to long-term time horizon. Trade tensions and policy uncertainties are likely to weigh on both intra-EU as well as extra-EU investment given their effects on the overall business confidence and risk aversion and the importance of conduit FDI for intra-EU investment flows.

The decline of both intra-EU and extra-EU FDI flows seems to be much less pronounced if flows through SPEs are not taken into account.

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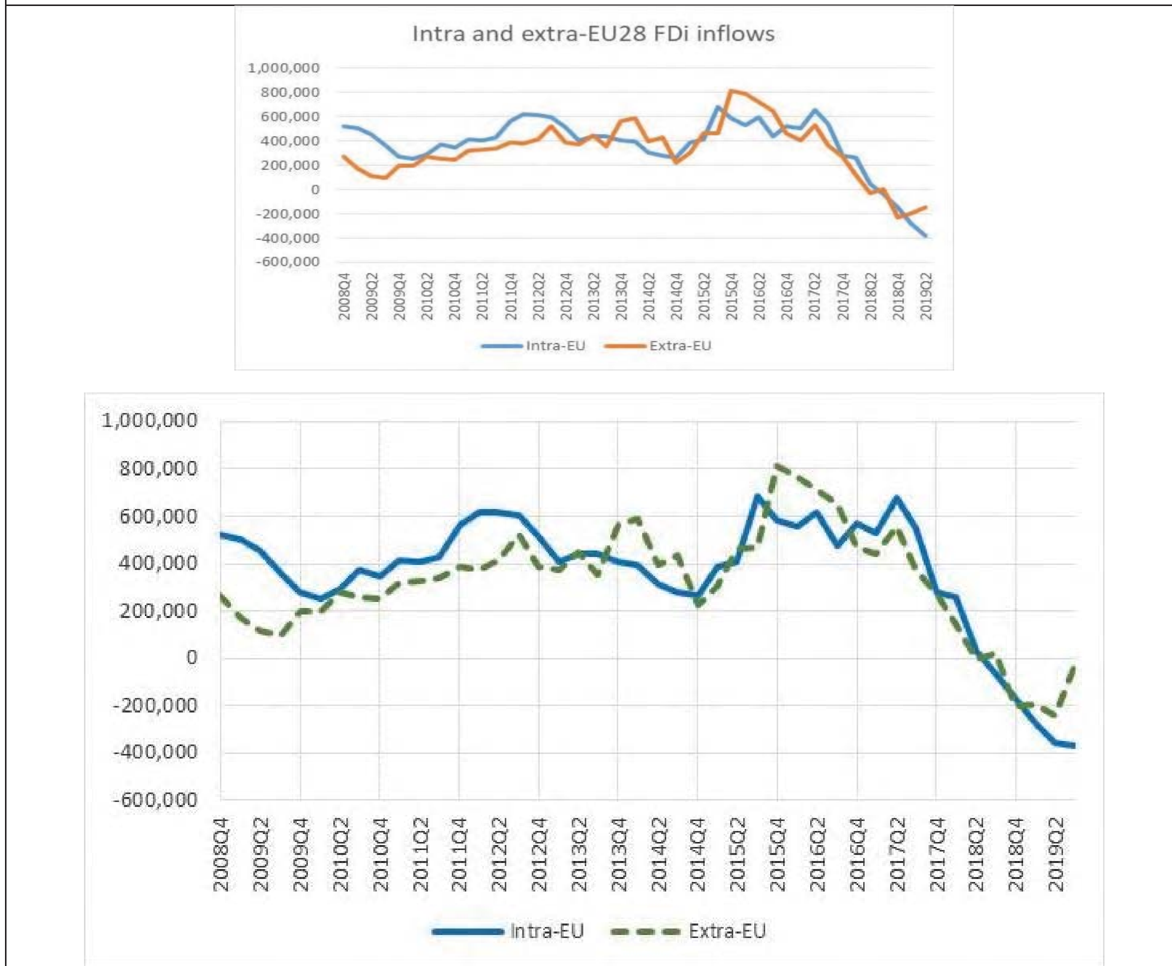
[5] FDI flows also include conduit FDI, i.e. FDI that does not flow directly from the ultimate investing country (UIC) to the ultimate host country (UHC), and can be, thus, counted multiple times in the gross flow statistics. In other words, conduit FDI can lead to an overestimation of gross 'genuine' flows.

Figure 2: Intra and extra-EU28 gross FDI inflows, 4-quarter moving sums



Source: DG FISMA based on EUROSTAT Balance of Payments quarterly data (BPM6). [amounts in EUR million]

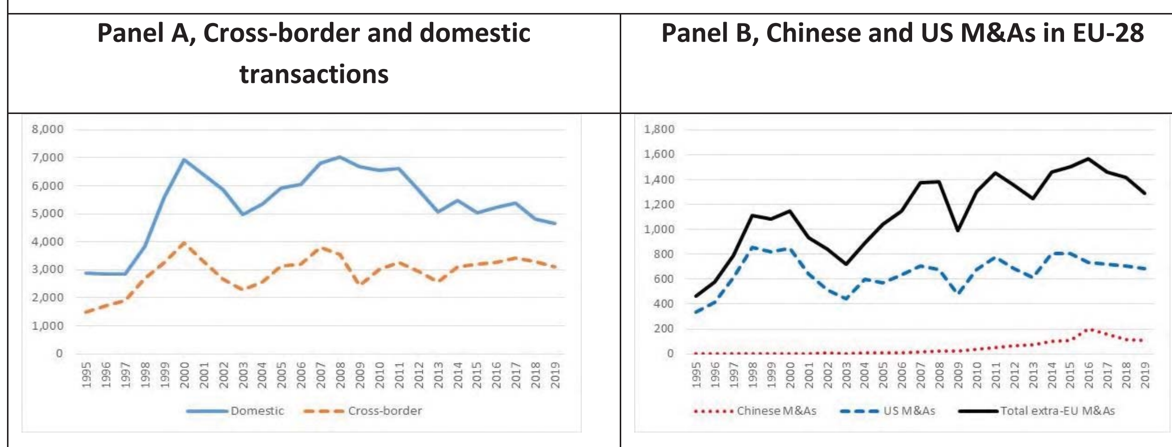
MERGERS AND ACQUISITIONS

Inward mergers and acquisitions (M&As) in EU-28 are expected to decline by almost 12% in 2019 for the second year in a row, following a more than 10% decrease in 2018 (see Figure 3, Panel A). Both domestic and cross-border transactions declined with the latter recording a slightly slower decline than the former. Among international transactions, extra-EU M&As contributed the most to the overall decline in 2019.

Chinese M&As into the EU continued to decrease as the reversal of the previously rapid growth in inward transactions that started in 2016 continued in 2019. US M&As in EU-28 also declined in 2019. The declines of the US and Chinese M&As in the EU contributed to respectively 12% and 27% of the overall reduction in the number of transactions in 2019.

Figure 3: Inward mergers and acquisitions in EU-28
number of transactions, 1995-2019

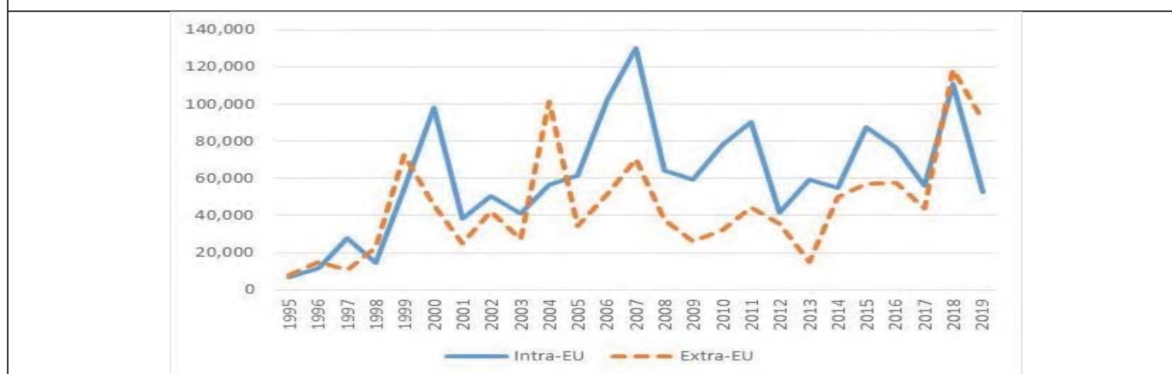
Panel A, Cross-border and domestic transactions	**Panel B, Chinese and US M&As in EU-28**



Source: DG FISMA based on DEALOGIC M&As ANALYTICS. *Note*: Latest data – as of 31 January 2020.

The value of international divestment through mergers and acquisitions[6] picked up in 2018 reaching levels close to those in 2007, but then normalised in 2019. The spike in the value of international divestment was caused by a few very large divestments of both intra-EU and extra-EU sellers.

Figure 4: International divestment through mergers and acquisitions
value of transactions in millions of euros



Source: DG FISMA based on DEALOGIC M&As ANALYTICS. *Note*: Latest data – as of 31 January 2020.

EU investors' preference for the single market also continued to strengthen in 2018-2019 with the number of intra-EU outbound M&As transactions[7] decreasing slower than that of extra-EU outbound transactions (see Figure 5).

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6 M&As in which a previously foreign-owned company within the EU is sold either to another foreign company or to domestic investors.

7 Cross-border M&As in which the acquiring company is in the EU, while the target company is either in the EU or outside the EU.

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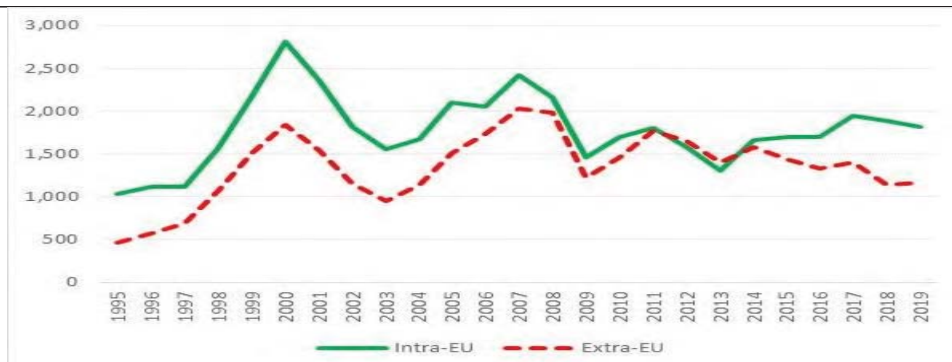
Figure 5: Preference for the single market in outbound mergers and acquisitions
number of transactions



Source: DG FISMA based on DEALOGIC M&As ANALYTICS. *Note*: Latest data – as of 31 January 2020.

2.3 Portfolio investment developments

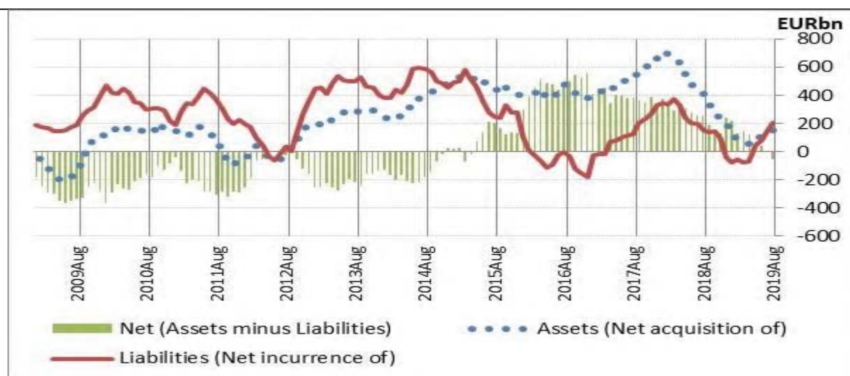
Global portfolio investment trends in recent years have been largely driven by the interest differential between the euro and the dollar, which widened again after a period of euro optimism in late 2017 and early 2018.

In the first half of 2018, the size of the acquisition of EU and euro area net foreign assets — in particular of portfolio debt outflows — fell in comparison to previous years (see Figure 6). This was motivated by the expectation of better economic prospects for the euro area and an eventual monetary tightening by the European Central Bank (ECB) which had increased yields. At the same time, the actual interest rate differential between the US and the euro area pushed the cost of hedging dollar investments higher. As a result, the hedged yield of (risk-free) dollar investments became less appealing than the euro equivalent over time.

Due to worsening economic prospects and a widening interest rate differential, net portfolio debt outflows from the euro area intensified in the second half of 2019. Given the difference in the speed of the economic recovery between the two regions during 2013-2014 and actual and expected Fed rate hikes, the interest rate differential between the US and the euro area has been the biggest driver of the net portfolio investment outflows from the euro area in recent years.

At the same time, the strengthening of the US dollar throughout 2018 had a major effect on global trends, similar to the appreciating euro the year before. Partly due to this, emerging market currencies severely depreciated in the course of the year, but their value seemed to have stabilised in the first half of 2019. This was partly due to the weakening global outlook of the previous several months which altered expectations about the monetary policy of both the Federal Reserve and the ECB.

Figure 6: Euro area net and gross portfolio investment flows



Source: DG FISMA based on ECB.

2.4 Indicators for financial integration: home bias in EU's equity and bond markets

Home bias refers to the preference of investors to invest a part of their portfolios in domestic equities or debt instruments, regardless of the advantages of having an internationally diversified portfolio as described by the theory on capital asset pricing model.

Intra-EU and global home bias with macro data

Figure 7 and Figure 8 present two indicators for home bias in portfolio investment[8]. The first (intra-EU home bias, Figure 7) captures the propensity to invest in rest of the EU-28 countries as compared with investing domestically, while the second (extra-EU home bias, Figure 8) shows the propensity to invest outside the EU rather than domestically. The first measures the attractiveness of the intra-EU capital market, while the second captures the interconnection of EU Member States with global markets. A decline in intra-EU home bias represents a rise in financial integration among EU countries. The lower the home bias, the higher is the share of investment within the EU as compared to the domestic market.

The intra-EU home bias (Figure 7) increased from 77% in 2009 to 79% in 2011 and then went back down to the 2009 level in 2018. Euro-area countries account for most of the reduction. In 2018 the home bias of euro-area countries was 20 points below that of the non-euro ones whose intra-EU home bias stood at 91%. Home bias in both groups of countries was highly stable in 2017.

[8] Details on the computation are available in Nardo, M., Ndacyayisenga, N., Pericoli, F. and Poncela, P., Commission SWD on the Movement of Capital and the Freedom of Payments, EUR 29191 EN, Publications Office of the European Union, Luxembourg, 2018, ISBN 978-92-79-81827-1, doi:10.2760/322204, JRC110773.

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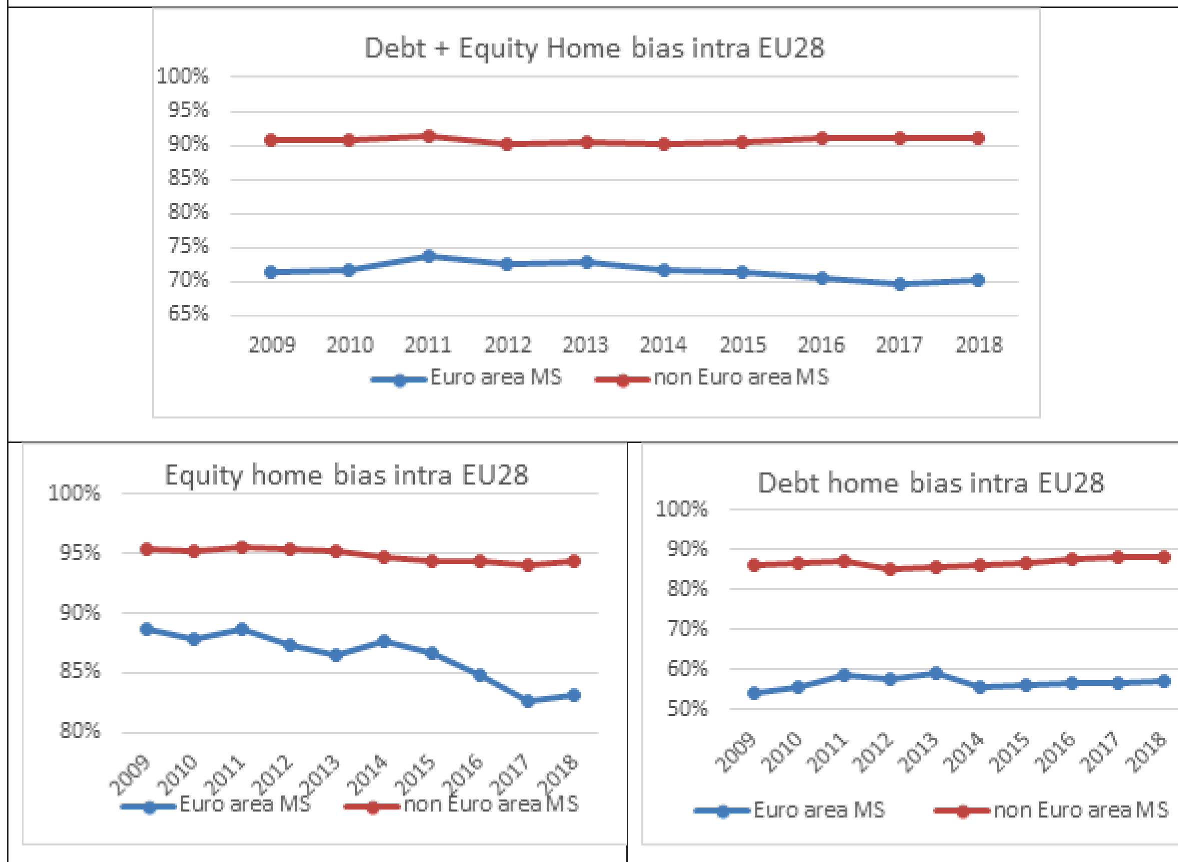
The intra-EU home bias is the average of equity and debt portfolio instruments, which each have different patterns. Compared with debt, equity is more biased towards domestic investment though this trend is decreasing. During the last 4 years intra-EU equity home bias for euro-area countries dropped from 88% in 2014 to 83% in 2018. However, intra-EU home bias for debt peaked at 59% during the sovereign crisis and then stabilised at 56% for euro-area countries. For non-euro area countries the trend is different. Debt home bias reached a high of 88% in 2018 up from 86% in 2014, while equity remained almost unchanged at around 94-96% for the entire observation period.

Figure 7: Intra-EU home bias for EU-28, yearly average for debt and equity

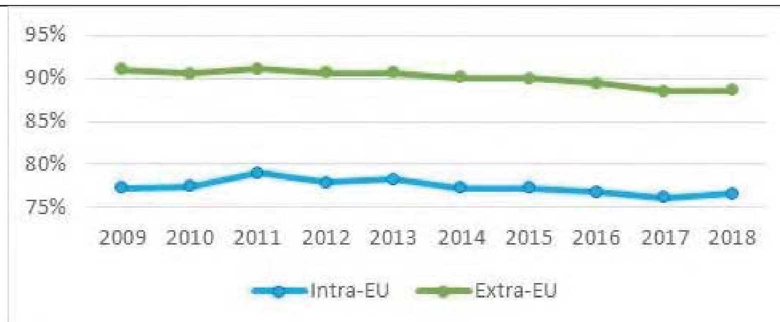


Source: JRC computations based on the JRC-ECFIN FinFlows database.

Notes: Only portfolio debt and equity investment positions as defined in the national accounts are taken into account. Cross-border banking flows and FDI are excluded from the computation.

For EU-28 the integration with global markets is, on average, 15 percentage points lower than the integration within Europe. The extra-EU home bias was as high as 89% in 2018 for the EU-28, falling gradually from 91% in 2009, with both euro and non-euro countries following a similar trend. The high value of extra-EU home bias is mainly due to equity — with a steady decrease in the last 3 years reaching 91% in 2018. There is also a decreasing trend in the debt market, where most of the reduction relates to euro-area countries (from 86% in 2013 to 83% in 2018).

Figure 8: Intra and extra-EU home bias indicator for EU-28, yearly average for debt and equity



Source: JRC computations based on the JRC-ECFIN FinFlows database.

2.5 Risk diversification within the EU through portfolio investments

Foreign portfolio investments are an important factor in risk sharing. These investments are expected to smooth domestic income changes when there are domestic shocks and to allow investors to hedge domestic risk by holding a cross-border portfolio. Figure 9 shows the diversification of cross-border portfolio assets and liabilities within the EU[9] for each Member State. Diversification of liabilities (assets) is a measure of the attractiveness of domestic assets (foreign liabilities) in the remaining EU portfolios and is evaluated based on: (1) the number of cross-border links; and (2) the relative size (within the EU) of the country where the investment is done. Higher diversification implies, other things being equal, a wider and stronger pool of cross-border partnerships and a lower dependency on common economic cycles.

Figure 9 compares the levels of risk diversification that Member States have achieved through portfolio assets and liabilities[10]. It also illustrates whether Member States achieved higher diversification through their portfolio assets or through their portfolio liabilities[11].

It shows essentially two groups of EU Member States. The first group, mostly composed of euro-area countries plus Denmark, Sweden, and the UK, have strong diversification in both portfolio assets and liabilities. The remaining non-euro area countries as well as

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[9] Details on the computation are in Nardo, M., Ndacyayisenga, N., Pericoli, F. and Poncela, P., JRC.B1 contribution to the SWD on the Movement of Capital and the Freedom of Payments, EUR 29191 EN, Publications Office of the European Union, Luxembourg, 2018, ISBN 978-92-79-81827-1, doi:10.2760/322204, JRC110773.

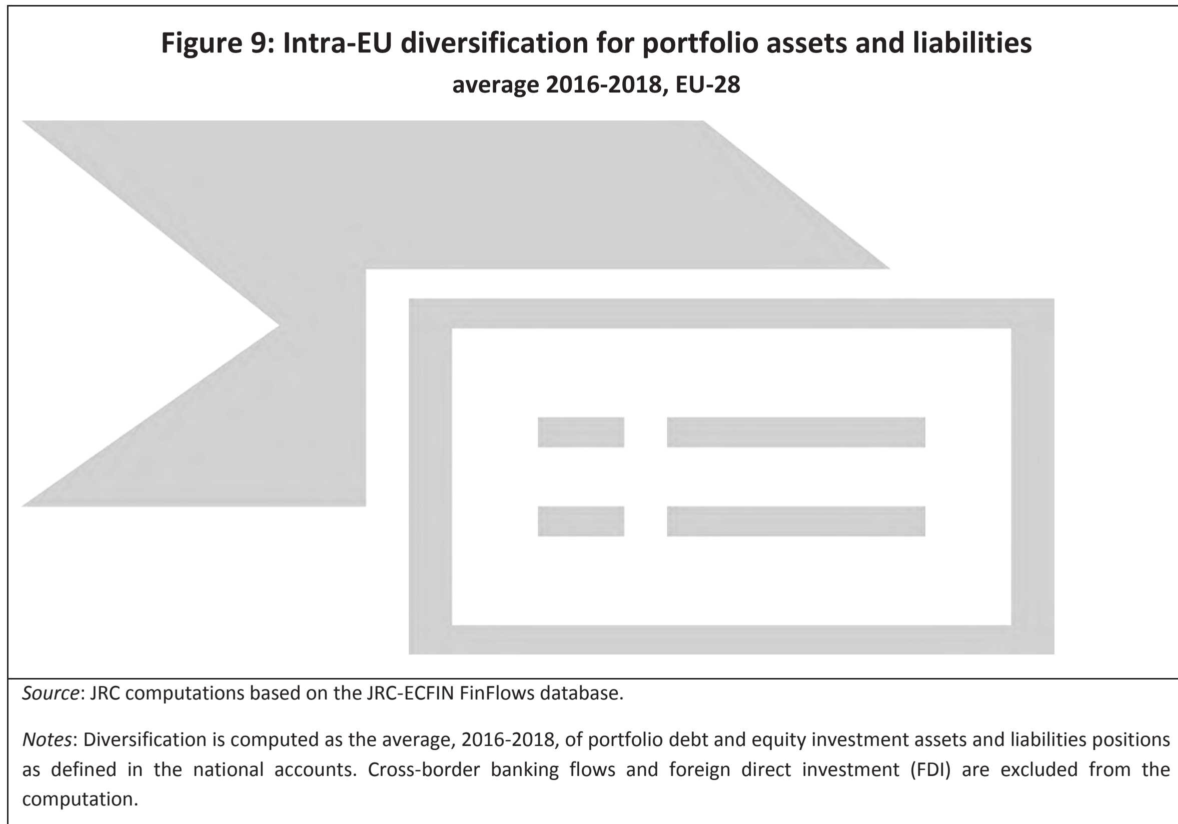
[10] Member States that are further away from the intersection of the axes at the zero level have achieved higher levels of diversification through their portfolio investments.

[11] Member States that are above the 45 degrees line achieve higher diversification through their foreign portfolio assets (holdings abroad) than from their foreign portfolio liabilities (foreign holdings of domestic securities).

Slovakia, Malta, Cyprus, Latvia, Lithuania and Estonia have lower diversification in both assets and liabilities with a difference of 20 percentage points on average.

Trends show that for the EU as a whole, diversification measures were relatively stable in 2016-2018 compared to 2013-2015[12]. Looking at country-level dynamics, Estonia, Malta and Romania increased their diversification in liabilities by more than 8 percentage points, while Poland and Estonia improved their asset diversification by 9 percentage points.

Figure 9: Intra-EU diversification for portfolio assets and liabilities
average 2016-2018, EU-28



Source: JRC computations based on the JRC-ECFIN FinFlows database.

Notes: Diversification is computed as the average, 2016-2018, of portfolio debt and equity investment assets and liabilities positions as defined in the national accounts. Cross-border banking flows and foreign direct investment (FDI) are excluded from the computation.

3 LEGAL FRAMEWORK UNDERLYING THE FREE MOVEMENT OF CAPITAL AND PAYMENTS

3.1 Legal framework

The principle of free movement of capital lies at the heart of the single market and is one of its four fundamental freedoms. The Treaty on the Functioning of the European Union (TFEU) does not contain an explicit definition of capital movements. However, in its jurisprudence the Court of Justice of the European Union (CJEU) has consistently established a broad definition of capital movements[13]. According to this jurisprudence, capital movements cover many operations, including:

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[12] In EU-28 diversification of liabilities were at 50% while diversification of assets' were at 42%.

[13] Based on the nomenclature annexed to Council Directive 88/361/EEC.

- FDI, real estate investments and purchases;
- securities investments (e.g. in shares, bonds, bills and unit trusts);
- transactions in securities on capital markets, admission of securities to capital markets;
- operations in units of collective investment undertakings;
- premiums and payments in respect of life and credit assurance; and
- granting of loans and credits and other operations, including personal capital operations such as dowries, inheritances and legacies, gifts and endowments.

As a rule, all restrictions on the movement of capital between Member States and between Member States and non-EU countries are prohibited (Article 63 TFEU). The CJEU has interpreted the term 'restriction' to mean all measures liable to make cross border capital movements less attractive[14]. However, the TFEU provides for the possibility to restrict capital movements, for the reasons referred to in Article 65 TFEU and, for non-discriminatory restrictions, for overriding reasons in the public interest. In particular, Article 65 TFEU provides that the free movement of capital is without prejudice to certain powers of Member States. These include: a) the power to apply the relevant provisions of their tax law that distinguish between taxpayers who are not in the same situation with regard to the place of residence or the place where the capital is invested, and b) the power to take precautions and supervisory measures, especially in the fields of taxation and the prudential supervision of financial institutions. Moreover, Article 65(1)(b) TFEU preserves the power of Member States 'to take measures which are justified on grounds of public policy or public security'.

In any case, restrictive measures must respect the principle of proportionality. As such, they must be suitable for attaining the objective sought, they must not go beyond what is necessary to achieve that objective and cannot be replaced by less restrictive alternative means[15]. Moreover, national measures must comply with other general principles of EU law, such as legal certainty, and with the fundamental rights[16]. Furthermore, the

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[14] Judgment of 26 April 2012, Van Putten, Joined Cases C- 578/10 to C- 580/10, paragraph 40 and case law cited therein. See also judgment of 13 mai 2003, Commission v Spain («golden shares»), C-463/00, ECLI:EU:C:2003:272, para 58.

[15] Judgments of 6 March 2018, SEGRO, C- 52/16 et C- 113/16, EU:C:2018:157, paragraph 76; of 21 May 2019, Commission v Hungary ("usufruct"), EU:C:2019:432, paragraphs 59-61.

[16] Judgment of 5 July 2012, *SIAT*, C-318/10, EU:C:2012:415, paragraph 58; Judgment of 30 April 2014, *Pfleger*, Case C- 390/12, EU:C:2014:281, paragraph 35; *Commission v Hungary ("usufruct")*, cit., paragraph 63. See also Judgment of 12 June 2003, Schmidberger, C-112/00, EU:C:2003:333, paragraphs 79 et seq.

exceptions provided in the TFEU must not be invoked as cover for arbitrary discrimination or a disguised restriction on the free movement of capital and payments (Article 65(3) TFEU).

Partly different considerations apply to the movement of capital to and from non-EU countries. The CJEU has stressed that it 'takes place in a different legal context' from that which exists within the EU. Consequently, under the Treaty additional justifications may be acceptable in the case of non-EU country restrictions[17]. Justifications may also be interpreted more broadly[18]. Moreover, any restrictions on certain capital movements (direct investment, real estate, the provision of financial services and the admission of securities to capital markets) existing before the liberalisation of capital movements are grandfathered under Article 64(1) TFEU. The relevant date is 31 December 1993 for all Member States except Bulgaria, Estonia and Hungary (31 December 1999) and Croatia (31 December 2002). This means that restrictions on certain capital movements in place before these dates that affect nationals of non-EU countries cannot be challenged on the basis of the principle of the free movement of capital under the Treaty.

The Treaty also provides for certain restrictions that can be adopted by the EU under certain specific conditions. The Council may, by means of a Regulation, interrupt or reduce, in part or completely, the economic and financial relations with one or more non-EU country if deemed necessary to achieve the objectives of the common foreign and security policy (Article 215(1)). Such restrictive measures or sanctions may particularly affect exports, imports, transfers of funds, investment and access to the EU's capital markets. Furthermore, Article 75 TFEU provides for a derogation from the free movement of capital and payments in order to meet objectives in the area of freedom, security and justice related to preventing and combating terrorism. Such restrictive measures (sanctions) may include freezing the funds, financial assets or economic gains of companies, individuals, groups or non-state entities. Finally, the Council may take temporary safeguard measures in exceptional situations when movements of capital with non-EU countries cause, or threaten to cause, serious difficulties for the operation of the economic and monetary union. The general principles of EU law, including the principle of proportionality and the respect for fundamental rights, also apply in this context.

3.2 Infringement proceedings

In its Communication on EU law titled 'Better results through better application'[19], the Commission clarified its approach to its infringement policy, namely that it should

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[17] Judgment of 18 December 2007, *Skatteverket*, cases C-101/05, paragraph 36; Judgment of 12 December 2006, *Test Claimants in the FII Group Litigation*, C-446/04, EU:C:2006:774, paragraph 171.

[18] See, for example, Judgment of 12 December 2006, Test Claimants in the FII Group Litigation, C-446/04, EU:C:2006:774.

[19] https://ec.europa.eu/info/publications/communication-commission-eu-law-better-results-through-better-application_en

support the achievement of EU policy objectives. The Commission targets problems where its enforcement action can make a real difference and provide real added value to individuals and businesses.

In line with the Commission's priorities and its political commitment to be more strategic in enforcing EU law, the Commission decided to act firmly on infringements that risk undermining the four fundamental freedoms.

In 2019, the Court of Justice found in its judgment that Hungary has failed to fulfil its obligations arising from the free movement of capital and the **right to property** guaranteed by the EU Charter of Fundamental Rights[20]. The Commission referred Hungary to the Court of Justice of the EU for failure to bring national rules terminating certain usufruct rights on agricultural land in line with EU law.

During the reporting period, the Commission decided to close three infringement cases related to free movement of capital, following action by the concerned Member States in remedying the contested violation of EU law: two against Lithuania and Slovakia related to the **acquisition of agricultural land**, and one against Croatia, linked to **special rights of the state** in a private company.

Another area where the Commission has taken action as guardian of the Treaties to ensure free movement of capital is **direct taxation**. Member States must act in compliance with EU law, including the principle on the free movement of capital. During the reporting period[21], the Commission launched seven infringement proceedings under Article 63 TFEU and Article 40 of the European Economic Area Agreement against Spain, Italy, Hungary, Latvia and the United Kingdom by sending letters of formal notice.

During the same period, the Commission closed 16 infringement proceedings on tax restrictions to the free movement of capital. By 31 December 2019, there were 25 open infringement proceedings against Member States for violations in the field of direct taxation in relation to the free movement of capital.

In 2018, the Court of Justice delivered two judgments on actions brought by the Commission against France and Belgium for violations of the principle of free movement of capital in the field of direct taxation.

In the first case, the Court decided that France had failed to fulfil its Treaty obligations by refusing to take into account the tax incurred by a non-resident subsidiary in the mechanism for the avoidance of economic double taxation, which permits offsetting the tax levied at every level of the distribution of dividends[22].

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[20] See footnote 15.

[21] From 1 January 2018 to 31 December 2019.

[22] Judgment of 4 October 2018, *Commission v France*, Case C-416/17, EU:C:2018:811.

In the second case, the Court declared that Belgium had failed to fulfil its obligations by retaining provisions under which the rental income of Belgian taxpayers from foreign immovable property is calculated on the basis of the actual rental value, but from property located in Belgium — based on the cadastral value[23].

3.3 Monitoring

3.3.1 Framework for investment protection

In July 2018, the Commission adopted a Communication on the protection of intra-EU investment[24], which gives an overview on the rules on available remedies for investment protection.

The Commission's aim was to underline the protection enjoyed by investors under existing EU law and explain the implications of the *Achmea* judgment[25] of March 2018 whereby the Court of Justice found the arbitration clauses in intra-EU bilateral investment treaties (intra-EU-BITs) incompatible with EU law.

In the *Declarations of 15 and 16 January 2019*[26] *on the legal consequences of the judgment of the Court of Justice in Achmea and on investment protection in the European Union*[27], all Member States committed to a coordinated approach for the implementation of the *Achmea* judgment by terminating their intra-EU BITs by means of a single plurilateral agreement. The declarations still acknowledge that bilateral terminations are possible 'where that is mutually recognised as more expedient'.

Member States' experts, with the Commission's assistance, worked on the text of a plurilateral termination agreement in the framework of an *ad hoc* special group for the termination of intra-EU BITs. The group met nine times between November 2018 and June 2019 and prepared a draft agreement, which fulfils the commitment to coordinated termination, while taking account of the different interests involved and ensuring legal certainty and compliance with EU law.

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23 Judgment of 12 April 2018, *Commission v Belgium*, Case C-110/17, EU:C:2018:250.

24 https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2018 %3A547 %3AFIN

25 Judgment of 6 March 2018, *Slowakische Republik v Achmea BV*, Case C-284/16, EU:C:2018:158.

26 Declarations of 15 and 16 January 2019: i) Declaration of the Representatives of the Governments of the Member States of 15 January 2019 on the legal consequences of the judgment of the Court of Justice in *Achmea* and on investment protection in the European Union; ii) Declaration of the Representatives of the Governments of the Member States of 16 January 2019 on the enforcement of the judgment of the Court of Justice in *Achmea* and on investment protection in the European Union, signed by Finland, Luxembourg, Malta, Slovenia and Sweden; iii) Declaration of the Representative of the Government of Hungary of 16 January 2019 on the legal consequences of the judgment of the Court of Justice in *Achmea* and on investment protection in the European Union.

27 https://ec.europa.eu/info/publications/190117-bilateral-investment-treaties_en

On 24 October 2019, the vast majority of EU Member States endorsed the draft text of the plurilateral termination agreement at a meeting of their Ambassadors and Permanent Representatives to the European Union[28]. The agreement will be signed in early 2020 once the applicable national empowerment procedures have been completed.

3.3.2 Investments in real estate and agricultural land

The free movement of capital includes investments in real estate according to the nomenclature annexed to Directive 88/361/EEC on the liberalisation of capital movements. Although the Directive is no longer applicable, the annex may still be used to determine what is covered by the free movement of capital (Article 63 TFEU)[29]. According to the explanatory notes of that Directive, investment in real estate covers purchases of buildings and land, the construction of buildings as well as rights of usufruct, easements and building rights[30]. In addition, the CJEU has clarified that the free movement of capital includes the right to acquire, use or dispose of immovable property[31].

Within the scope of Article 63 TFEU, cross-border investments must not be restricted by national law, unless the restrictions are proportionate to pursue a legitimate objective and respect fundamental rights[32]. Hence, restrictions may differ from one Member State to another. The Commission is assessing national restrictions to the free movement of capital on a case-by-case basis.

In recent years, the Commission has had to look into restrictions on investments in agricultural land. Some Member States adopted new laws on the acquisition of agricultural land following the expiry of transition periods during which they were allowed to derogate from the free movement of capital rules[33]. The new land laws generally pursue policy objectives such as keeping land in agricultural use and preventing excessive land speculation and concentration. However, the Commission has found some of these laws to be discriminatory and overly restrictive. As from 2015, it therefore took legal action against Bulgaria, Hungary, Lithuania, Slovakia and Latvia[34].

On 27 April 2017 the European Parliament adopted a resolution on the ‘State of play of farmland concentration in the EU — how to facilitate access to land for farmers’. The

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28 https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/191024-bilateral-investment-treaties_en.pdf

29 CJEU Joint cases C- 52/16 und C- 113/16, ECLI:EU:C:2018:157 n 56 — SEGRO und Horváth.

30 CJEU C- 235/17, ECLI:EU:C:2019:432 n 55 — Commission v Hungary.

31 CJEU, C-567/07, ECLI:EU:C:2009:593, n 20 — Woningstichting Sint Servatius.

32 CJEU C- 235/17, ECLI:EU:C:2019:432 n 59, 63 — Commission v Hungary.

33 The transitional derogations granted to Bulgaria, Romania, Hungary, Slovakia, Latvia and Lithuania under their respective Accession Treaties expired in 2014, and for Poland in 2016.

34 http://europa.eu/rapid/press-release_IP-16-1827_en.htm

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Parliament called on the Commission to provide guidance to Member States on how to regulate agricultural land markets in line with EU law. The Commission responded to this resolution by adopting an 'Interpretative Communication on the Acquisition of Farmland' on 12 October 2017[35]. Following the adoption of the Communication, Lithuania and Slovakia aligned their land laws with EU law so that the Commission could close the respective infringement procedures in 2019. Some Member States are in the process of acting similarly, while others have not yet taken any initial step in this direction. The Commission continues to engage with the Member States and stakeholders on the farmland challenges[36].

The transition period, during which Croatia can derogate from free movement of capital with respect to agricultural land, will expire on 1 July 2020. Under the Accession Treaty, the country has the possibility to apply for a 3-year extension of the transition period.

3.3.3 Lending in foreign currencies

In the years before the financial crisis, banks in several Member States issued substantial numbers of foreign-currency (mostly CHF) loans to private households, largely due to the more favourable LIBOR interest rates at that time. However, following the global financial crisis and because of unfavourable exchange rate movements, in some Member States a large number of those loans became non-performing, as many borrowers could no longer pay back the significantly increased monthly instalments. Many consumers and consumer organisations challenged the validity of certain clauses contained in foreign-currency loans as unfair and not compliant with EU consumer protection law.

In recent years, the CJEU has developed a substantive body of case-law on the level of consumer protection under EU law relating to those foreign-currency loans and on the criteria to be applied by the national courts when they assess the unfairness of certain clauses and the legal consequences for those contracts. It is for the competent national judge to assess whether a certain contract term is unfair and needs to be removed from the contract and, if that unfair term defines the main subject matter of a contract, such as terms relating to the exchange risk for a loan indexed to a foreign currency, whether the contract can be upheld without that term[37].

Several Member States have adopted or are planning to adopt national regulatory measures to provide a systemic solution to remaining issues linked with foreign-currency retail loans. The Commission is closely monitoring these developments to ensure that any such measures comply with EU law. National measures that restrict the fundamental single market freedoms need to be duly justified by public interest objectives, must be

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[35] https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=OJ:C:2017:350:TOC

[36] On 3 June 2019, the Commission held a workshop on farmland market challenges and best practices.

[37] See the latest judgment of the Court in Case C-260/18 of 3 October 2019, *Kamil Dziubak and Justyna Dziubak v Raiffeisen Bank International AG*.

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suitable, not go beyond what is necessary to attain these objectives and not be replaceable by equally efficient but less restrictive means.

Whenever the Commission has doubts about whether a national measure complies with EU law, it seeks to engage in a dialogue with the Member State concerned. This is to find a solution that not only fully ensures compliance with EU consumer protection rights, but also takes into account financial stability and the general principles of EU law.

All credit agreements signed after 21 March 2016 are bound by the Mortgage Credit Directive[38] (MCD) which contains specific provisions that address the risks associated with foreign-currency loans.

3.3.4 Capital controls

Capital controls are one of the most severe exceptions to the principle of free movement of capital. However, they are necessary to prevent disorderly outflows from causing a financial and economic meltdown. The restrictions imposed recently in Greece and Iceland are examples of necessary restrictions on the free movement of capital within the EU/European Economic Area (EEA).

GREECE

Greece introduced capital controls in June 2015. At the time, the Commission found that the temporary restrictions imposed by the Greek authorities were justified because of the need to preserve the stability of the financial and banking system in Greece. The Greek authorities adopted a roadmap in May 2017 on the gradual relaxation of capital controls with a view to abolishing them, while at the same time safeguarding financial and macroeconomic stability.

Greece fully lifted capital controls on 1 September 2019, ending 4 years of restrictions on transfers abroad by companies and individuals.

ICELAND

Article 40 of the EEA Agreement establishes the principle of free movement of capital in the EEA. However, Article 43 expressly permits a contracting party to take ‘protective measures’ if there are disturbances in the functioning of its capital market, or if it is having difficulties with its balance of payments.

Capital controls were introduced in November 2008, after Iceland was struck by an unusually severe banking crisis in October 2008. Since then, the Commission has been monitoring the situation and discussing the best way forward with the Icelandic authorities and the European Free Trade Area Surveillance Authority. The Icelandic

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[38] Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014L0017.

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authorities aim to remove restrictions on the free movement of capital in the EEA while safeguarding Iceland's financial and economic stability.

After several rounds of relaxation measures adopted in the years leading up to 2017, on 14 March 2017, Iceland was granted full exemptions from nearly all restrictions. However, some minor capital controls remain in place — to prevent carry trade[39] for example. Households and businesses are generally no longer subject to the restrictions that the Icelandic Foreign Exchange Act imposed on foreign exchange transactions, foreign investment, hedging and lending activity in Iceland. The requirement that residents repatriate foreign currency has also been lifted. Foreign investments by pension funds, collective investment funds (UCITS) and cross-border transactions with Icelandic króna have been authorised. Foreign financial undertakings have been authorised to transfer króna and financial instruments issued in domestic currency to and from Iceland. An agreement was reached in 2017 with some owners of offshore Icelandic króna (which were subject to restrictions), whereby they sold approximately ISK 90 billion to the Central Bank of Iceland at ISK 137.5 per EUR.

In March 2019 the Icelandic authorities notified the Commission of further steps taken to relax capital controls. Now owners of offshore króna assets are given permission to release their assets from accounts subject to special restrictions:

(1) There is a general authorisation for offshore króna holders to release their króna assets in order to purchase foreign currency and export it to an account abroad.

(2) An authorisation has been granted for offshore króna holders that have owned offshore króna assets continuously since the introduction of the capital controls to release those offshore króna assets from the legal restrictions.

(3) There is an authorisation for individuals to withdraw up to ISK 100 million from accounts, subject to special restrictions.

The authorities expect that as much as half of the remaining ISK 84 billion in offshore króna assets could be withdrawn due to these new authorisations.

Rules on special reserve requirements for new foreign-currency inflows were amended in parallel, decreasing the special reserve requirement from 20% to 0%. Other provisions — for example on the special reserve base, interest rates on capital flow accounts and the holding period — remained unchanged.

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[39] A carry trade is a strategy in which an investor borrows money at a low interest rate in order to invest in an asset that is likely to provide a higher return. This strategy is very common in the foreign exchange market.

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4 MAIN DEVELOPMENTS IN THE AREA OF FREE MOVEMENT OF CAPITAL AND THE FREEDOM OF PAYMENTS

4.1 Addressing national barriers to the free movement of capital

4.1.1 Capital Markets Union

The Capital Markets Union (CMU) continues to be a very important priority for the EU. It is necessary to complement the Banking Union and to strengthen the economic and monetary union and the international role of the euro. The CMU is also an important single market project. One of its main objectives is to remove the remaining cross-border barriers to capital markets investments in the EU in order to create a genuine single market for capital. This should enable savers and companies to access investment opportunities and funding at similar terms anywhere in the EU, irrespective of their location or the state of development of their local capital markets.

All of the legislative measures announced in the 2015 CMU action plan and in the 2017 midterm review of the CMU action plan have been delivered by the Commission, including the legislative proposals that contribute to removing barriers to cross-border investments. The Commission presented an overview of the progress achieved in its Communication of 15 March 2019 entitled 'Capital Markets Union: progress on building a single market for capital for a strong Economic and Monetary Union'[40].

Since September 2015, the Commission, the European Parliament and the Council have agreed on a number of legislative acts that put in place the building blocks of a CMU. Together they seek to:

(1) promote access to pan-European products and labels via the reviewed venture capital (EuVECA) Regulation, cut red tape for companies seeking public listing (Prospectus review), and help establish a pan-European market for personal pension products;

(2) increase the transparency and integrity of the markets via new rules on simple, transparent and standardised (STS) securitisation, introduce more proportionate prudential treatment of investment firms and a harmonised framework on covered bonds; and

(3) remove cross-border barriers to the integration of capital markets by harmonising key pre-insolvency procedures and strengthen the supervisory convergence role of the European supervisory authorities.

While it is still difficult to assess the impact of the recently adopted legislative proposals as most of them have not been in force for long enough, more work will certainly be needed to achieve a fully-fledged CMU. Long-term trends, such as those triggered by technological development, Brexit and the need to transition towards a climate-neutral

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[40] https://ec.europa.eu/finance/docs/policy/190315-cmu-communication_en.pdf

economy, will affect the future of Europe's capital markets. More work will also be needed in areas where progress has so far been slower, such as: (i) access to financing and development of adequate ecosystems for SMEs; (ii) efficient and better integrated market architecture; (iii) retail investor participation; and (iv) structural cross-border barriers due to, for example, divergent national insolvency regimes and inefficient withholding tax procedures.

For this purpose, the Commission has created a High-level Forum on capital markets (HLF) to engage with market participants, civil society and academics. The HLF will propose targeted policy recommendations for future CMU actions, to ensure that and businesses and individuals reap the full benefits of the single market.

4.1.2 Withholding tax

Burdensome procedures for recovering tax withheld on portfolio investments have long been identified by Member States and the Commission as a barrier to a true EU capital market. They penalise cross-border investments, disrupt financial processes such as clearing and settlement, and increase the cost of cross-border trading. The resulting misallocation of financial resources undermines cross-border investments, which in some cases result in double taxation (as long as the due refunds are not carried out according to bilateral taxation treaties). The 2017 report on national barriers to capital flows[41] and its follow-up, the 2017 joint roadmap[42] identified a series of best practices on withholding tax (WHT) recovery proceedings (in addition to relief at source). The Code of conduct on withholding tax[43], published in 2017, is a first non-binding deliverable of the CMU action plan in the area of taxation. It seeks to address on a voluntary basis the long-standing problem of long delays and costs in recovering taxes withheld in the country of investment.

The 2017 Code calls for voluntary commitments by Member States and it should be considered as a compilation of approaches to improve the efficiency of current WHT procedures. Its main goal is to seek alignment between the approaches laid down by the Code and Member States' tax administrations practices on withholding tax procedures. In particular, the approaches set in the Code to improve the efficiency on WHT procedures are, among others, easy access to the refund process, encouraging digital procedures, use of user-friendly forms, no delay in refund periods or appointing single points of contact in each Member State. A public hearing took place in January 2018 to present the Code and raise awareness among key stakeholders.

In the reporting period, there were two implementation meetings on the state of play of the Code (on 21 June and 18 November 2019), which showed some progress overall.

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[41] https://ec.europa.eu/info/files/170227-report-capital-barriers_en

[42] https://ec.europa.eu/info/files/170519-roadmap-national-capital-barriers_en

[43] https://ec.europa.eu/taxation_customs/sites/taxation/files/code_of_conduct_on_witholding_tax.pdf

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Most Member States have national relief at source systems, but only a few of them apply it to every situation. The average time between a claim and refund still varies widely between Member States however, most of them, process the tax refund on average within six months, in line with the Code of Conduct. In the area of digital withholding tax procedures little progress has been recorded since the Code was published. Therefore, there is still significant scope for improvement, especially in the area of the standardisation of withholding tax procedures where the Code has proven to be insufficient.

4.1.3 Cross-border distribution of funds

Facilitating cross-border distribution of investment funds is one of the CMU's priority actions. A truly open single market for European investment funds is expected to offer investors a better choice. This is because the removal of administrative and regulatory obstacles will reduce market fragmentation, bring greater economies of scale and increase competition across the EU. The legislative package on cross-border distribution of investment funds was published in the Official Journal in July 2019[44]. It tackles regulatory barriers, which represent a strong disincentive to cross-border fund distribution. While more work is needed to complete the single market, the package contains the following main improvements:

(1) It makes it easier for EU alternative investment fund managers to test the appetite of potential professional investors in new markets (so-called ‘pre-marketing’). This will help them take more informed commercial decisions before entering a new market.

(2) It clarifies customer service obligations for asset managers in their host Member State. This should ensure that investors have access to uniform, high-level customer service across the EU without requiring asset managers to be physically present.

(3) It aligns procedures and conditions to exit national markets when asset managers decide to terminate the offering or placement of their funds ('de-notification procedure').

(4) It increases transparency and introduces a single, online access point to information on national rules on marketing requirements and applicable

[44] Directive (EU) 2019/1160 of the European Parliament and of the Council of 20 June 2019 amending Directives 2009/65/EC and 2011/61/EU with regard to cross-border distribution of collective investment undertakings (Text with EEA relevance.) OJ L 188, 12.7.2019, p. 106-115, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32019L1160, and Regulation (EU) 2019/1156 of the European Parliament and of the Council of 20 June 2019 on facilitating cross-border distribution of collective investment undertakings and amending Regulations (EU) No 345/2013, (EU) No 346/2013 and (EU) No 1286/2014 (Text with EEA relevance.) OJ L 188, 12.7.2019, p. 55-66, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32019R1156.

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supervisory fees, which will help reduce the legal and administrative cost of cross-border activities of asset managers in the EU.

The package entered into force on 31 July 2019 and will fully apply when it is turned into national laws by August 2021.

4.2 The international role of the euro

The euro is the second most used currency globally. It is used for example for cross-border payments, as a reserve currency, for issuing international debt, and for granting or taking up international loans. The free flow of capital, both within and in and out of the euro area is a key prerequisite for strengthening the international role of the euro. In turn, its increased international role should lead to more capital movements across the euro area border.

The Commission adopted the Communication 'Towards a stronger international role of the euro' in December 2018 to strengthen the integrity and stability of the euro system, and to provide opportunities to people and businesses across the world to use the euro. While it is ultimately up to market participants to choose which currencies they use on the international stage, the objective is to increase the attractiveness of the euro for global market participants and investors as well as make the euro area more autonomous. Progressing towards a system that relies less strongly on just one currency would add stability to, and be in the interest of, the global community. Strengthening the international role of the euro is part of the EU's broader commitment to an open, multilateral and rules-based global economy.

A number of EU policies encourage financial market developments that help increase the role of the euro. Completing the banking union, the CMU and the economic and monetary union are fundamental components of the policy to increase the euro's international role. The banking union and the CMU increase the stability and efficiency — and therefore the attractiveness of — the euro area and of the euro as a dependable means of conducting business. Building on the financial stability provided by an effectively functioning banking union, the CMU aims for deeper and more liquid markets. To this end, CMU initiatives intend to diversify sources of financing, eliminate barriers to cross-border investments and offer more investment opportunities.

The Communication on the international role of the euro announced that the Commission intends to:

(1) make further use of European market infrastructure to widen the use of the euro in derivatives contracts, i.e.: financial instruments whose value depends on the value of underlying variables;

(2) underpin confidence in the use of euro-area financial markets by ensuring the availability of trustworthy interest-rate benchmarks, which act as reference rates in many financial contracts; and

(3) support a fully integrated instant payment system in the EU, to reduce the risks and the vulnerabilities of retail users of payment systems.

In addition, the Communication proposed to look at other policies that can increase the use of the euro in foreign exchange markets, energy contracting and transactions in certain strategic sectors (for example for certain commodities, such as oil and gas, raw materials, food commodities, and in the sector of transport manufacturing — aircraft, maritime transport and railways).

In the first half of 2019, the Commission launched consultations in several key strategic sectors, such as foreign exchange markets, energy, commodities and transportation. It published the results of these consultations in its staff working document titled 'Strengthening the International Role of the Euro — Results of the Consultations'[45] on 12 June 2019, and highlighted the need for a coordinated strategy that involves the EU, Member States and market participants, and requires economic diplomacy.

4.3 Payment services in the single market

4.3.1 Retail payments

With the adoption of Directive 2007/64/EC on payment services in 2007, the EU created a comprehensive legal framework on retail payments. The Directive introduced the concept of payment institutions to bring more competition to a market that was previously dominated by credit institutions.

Since then, the payment market has evolved significantly. Today, many innovative players are operating in the market. As a result, the market has become more competitive than ever before. Innovation has also led to new types of payment services, which were not regulated under Directive 2007/64/EC.

In 2015, the Directive was revised and modernised to take account of these new technological developments and to introduce stronger security measures to make electronic payments safer and more secure. The revised Directive ((EU) 2015/2366) came into force at the beginning of 2018 and is accompanied by a range of delegated acts. The most important of these is Commission Delegated Regulation (EU) 2018/389[46].

This delegated act became applicable on 14 September 2019. Accordingly, banks and other account-servicing payment service providers have to apply stricter security measures to their payments. They must also have in place communication interfaces that will allow providers of new types of payment services to access — with the explicit consent of the account holder who makes use of these services — the data of that account holder. These developments will have a catalyst effect on innovation in the area of

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[45] https://ec.europa.eu/info/files/strengthening-international-role-euro-sdw-2019_en

[46] Commission Delegated Regulation (EU) 2018/389 of 27 November 2017 supplementing Directive (EU) 2015/2366 of the European Parliament and of the Council with regard to regulatory technical standards for strong customer authentication and common and secure open standards of communication (Text with EEA relevance.), https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32018R0389.

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payments and other financial services, leading to the development of new payment and account-related services, eventually driving the market towards open banking.

4.3.2 Cross-border payments in euro

Regulation (EC) No 924/2009 on cross-border payments requires that fees for cross-border payments in euro within the EU (i.e. payments from one euro Member State to another) be the same as fees for domestic payments in euro (i.e. payments within the same Member State). Non-euro area Member States, although covered by the Regulation, have not benefited from the effects of the Regulation. In non-euro area countries, domestic payments in euro are either very expensive or simply do not exist. Consequently, people and businesses in these non-euro area EU Member States pay high fees whenever a payment crosses the border of their country or when people travel and pay abroad. These high costs are an impediment to the completion of the single market and create two categories of payment service users in the EU.

In March 2018, the Commission tabled a proposal seeking to extend the benefits of Regulation (EC) No 924/2009 to people and businesses in Member States outside the euro area and to put an end to the high costs of intra-EU cross-border transactions in euro made from non-euro area Member States. Further to the agreement between the European Parliament and Council, reached in December 2018, Regulation (EU) 2019/518 was published in the Official Journal of the EU on 29 March 2019. It ensures that as from 15 December 2019 individuals or companies transferring euros from these countries pay the same as they would for domestic transactions in the local currency.

The amendments to Regulation (EC) No 924/2009 also establish additional transparency obligations for currency conversion practices in line with Articles 45 and 59 of Directive 2015/2366 on payment services in the single market. These amendments seek to help users to compare currency conversion service offers before initiating a payment transaction involving a currency conversion. Transparency requirements will mostly apply as from 19 April 2020 and will particularly benefit consumers who travel to Member States with a different currency than that of their home country.

4.3.3 Single Euro Payments Area

Regulation (EU) No 260/2012 establishes technical and business requirements for credit transfers and direct debits in euro. The Regulation, known as the Single Euro Payments Area (SEPA) Regulation, adopted in 2012, has been another major step forward in the proper functioning of the single payments market. It has created an integrated market for electronic payments in euro, by migrating to EU-wide credit transfers and direct debits and introducing IBAN. This migration has led to significant savings as banks no longer encounter the high costs of running both 'legacy' and SEPA products in parallel. In addition, since 2012, payment services providers must ensure that where their accounts are reachable for domestic credit transfers and direct debits, those accounts are also reachable for cross-border credit transfers and direct debits. IBAN discrimination based on the location of the account is no longer permitted. Payers with an account in a country

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other than that of the payee should be able to make a SEPA transfer from their account just like any other payer with an account in the country of the payee.

At the end of 2017, the Commission issued the SEPA report on the application of the Regulation. The report concluded that the SEPA migration has been a success overall. However, the report identified a number of small challenges, including IBAN discrimination in a number of cases, including by utility companies and telecom providers. The report also highlighted that some Member States did not designate a competent authority capable of addressing non-compliance by payees, and even in those Member States that did, the authority was sometimes unable to enforce the SEPA Regulation, specifically in cases of IBAN discrimination. Since 2018, the Commission has focused its efforts on resolving these remaining obstacles to ensure that SEPA credit transfers and direct debits are accepted, irrespective of whether they are domestic or cross-border. In the follow-up of specific complaints, the Commission has launched EU-Pilots for several Member States to find out which steps are being taken to ensure that the payees concerned also respect the Regulation. In the case of Greece, Latvia[47] and Poland, the Commission launched infringement cases to ensure that a competent authority is designated in these Member States to address the non-compliance of the Regulation by payees[48].

4.4 Direct taxation and free movement of capital

The Commission's agenda to tackle tax evasion and avoidance has achieved notable success. This work on fairer taxation removes distortions that many companies face due to the aggressive tax planning of their competitors. A coordinated EU approach also helps to prevent a mixture of national anti-abuse measures from creating new obstacles for businesses in the single market. Recent policy initiatives in the field of taxation are therefore essential for achieving more integrated capital markets in the EU.

All of the initiatives announced in the 2015 action plan for fair and efficient corporate taxation in the EU[49] have now been launched with the aim of ensuring that every company pays tax where it makes its profits. Several initiatives have already been adopted to strengthen the EU anti-abuse provisions (in particular the Anti-tax avoidance Directives[50]) and to boost tax transparency. Most recently, on 25 May 2018 the Member States adopted an amendment to the Directive on administrative cooperation in direct

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[47] Latvia has made amendments to the Law on Payment Services and Electronic Money in this respect that came into force on 12 November 2019.

[48] See also section 3.2 for more information on infringements related to free movement of capital.

[49] Communication from the Commission to the European Parliament and the Council on 'A fair and efficient corporate tax system in the European Union: 5 key areas for action', COM(2015) 302, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52015DC0302.

[50] Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32016L1164.

taxation[51] to make intermediaries (e.g. advisers, consultants, lawyers and accountants) liable to report to their competent authorities on cross-border arrangements that include at least one of the risk indicators ('hallmarks') laid down by law. The first exchanges of information between Member States on the arrangements take place from 1 July 2020.

In October 2016, the Commission relaunched the Common Consolidated Corporate Tax Base by adopting two proposals that can be implemented in two stages[52]. Member States would as a first step implement the Common Corporate Tax Base (CCTB) and as a second step the Common Consolidated Corporate Tax Base (CCCTB). Both proposals are currently being negotiated in Council. The CCTB proposal includes provisions on an allowance for growth and investment (AGI), which aims to redress the current debt bias in taxation. The AGI will give companies similar tax benefits for equity as for debt, creating a more neutral and investment-friendly tax environment. Tackling this issue is one of the goals of the CMU, since the debt bias in taxation incentivises under-capitalisation, which can make companies more fragile and destabilise the economy.

Considerable progress has been made in the area of administrative cooperation in direct taxation in the EU. In 2016, financial institutions initiated customer due diligence on their account holders in compliance with the national measures implementing Directive 2014/107/EU on the mandatory automatic exchange of information in the field of taxation. The purpose is to collect financial account-information to be exchanged in accordance with the OECD's Standard for Automatic Exchange of Financial Account Information. The first automatic exchanges of information between tax administrations of the Member States took place in September 2017 and Austria joined the systematic exchanges in September 2018. This closer cooperation will allow tax administrations in the EU to ensure that taxpayers in each Member State comply with their national tax obligations for accounts held in other Member States. Improved tax compliance rules, in particular the self-certification procedures for tax residence included in the due diligence to be applied by financial institutions under the Directive, may help address the concerns of some Member States about applying withholding tax relief and refund procedures.

The existing savings taxation agreements between the EU and five non-EU European countries[53] (the Principality of Andorra, the Principality of Liechtenstein, the Principality of Monaco, the Republic of San Marino and the Swiss Confederation) have been updated to take into account the automatic exchange of financial account information based on the aforementioned OECD global standard. Two revised agreements (Liechtenstein and San Marino) entered into force on 1 January 2016 and the first automatic exchanges took

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[51] Council Directive (EU) 2018/822 of 25 May 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32018L0822.

[52] For more details, see: http://europa.eu/rapid/press-release_IP-16-3471_en.htm.

[53] https://ec.europa.eu/taxation_customs/individuals/personal-taxation/taxation-savings-income/2004-ec-agreements_en

place in September 2017. The three other revised agreements, including with the Swiss Confederation, entered into force on 1 January 2017 and the first exchanges took place in September 2018.

Following a proposal by the Commission in October 2016, the Member States adopted a Directive on tax dispute resolution mechanisms[54] in October 2017 that is applicable from 1 July 2019. This instrument lays down rules for resolving disputes more swiftly and efficiently between Member States that arise from the interpretation and application of tax treaties on the elimination of double taxation for businesses and individuals. The Directive creates an obligation to resolve the dispute within a set period of time and delivers an important innovation in that it offers guarantees for the rights of the taxpayer to trigger several stages of the dispute resolution procedure(s).

Against the background of the CMU, the Commission is also taking action to encourage Member States to simplify withholding tax relief/refund procedures for compliant tax payers (see Section 4.1.2 for more details) and encourage best tax practices in promoting venture capital[55] and business angel[56] investment in start-ups and innovative companies. The 2017 study on tax incentives for venture capital and business angels[57] found that taxation plays a role in supporting or hampering venture capital and business angel investment. The way in which tax incentives are designed could help lower the risk (upside and downside) of investments in SMEs and start-ups. The study observed 47 tax incentives designed to promote venture capital and business angel investment in the 36 countries sampled.

Taxation is one of the policy areas monitored by the European Semester, the EU's annual cycle of economic policy coordination. The main taxation priorities of the 2019 European Semester cycle were to stimulate productive investment, support employment, improve tax compliance and promote social fairness. In 2019, the Commission provided country-specific recommendations in the area of taxation to 17 Member States.

4.5 Macroprudential measures

The financial crisis highlighted the need for system-wide oversight and macroprudential measures. Macroprudential policy has been developed as a new EU policy area to limit systemic risk mainly by using prudential measures to address vulnerabilities that go beyond the scale of individual institutions.

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[54] Council Directive (EU) 2017/1852.

[55] Venture capital is financing that investors provide to start-up companies and small businesses with long-term growth potential.

[56] A business angel is a private individual, often of high net worth and usually with business experience, who directly invests part of his or her personal assets in new and growing private businesses.

[57] https://ec.europa.eu/taxation_customs/sites/taxation/files/final_report_2017_taxud_venture-capital_business-angels.pdf

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Capital movements may be a source of risks that can be mitigated by macroprudential measures that limit, for instance, excessive credit growth in one Member State. Reciprocation measures aim to ensure that macroprudential measures taken in one country to address an overheating housing market will not be rendered ineffective by increased lending through foreign bank branches or cross-border lending into that country.

The 2013 Capital Requirements Directive[58] and Capital Requirements Regulation[59] provide for a number of instruments for macroprudential use in the banking sector. Some instruments, like the countercyclical capital buffer (CCyB) and the buffer for global systemically important institutions (G-SIIs) are mandatory. Others, like the buffer for other systemically important institutions (O-SIIs), are not mandatory, although the identification of O-SIIs is mandatory. The EU macroprudential toolbox also encompasses other instruments whose application is discretionary. These include the systemic risk buffer (SyRB), measures under Articles 124 and 164 CRR, which can address vulnerabilities related to the real estate sector, and national measures under Article 458 CRR, which can only be used if no other measure in the EU macroprudential toolkit can adequately address emerging national systemic risks.

Given that macroprudential risks may be very specific to a given country, the framework provides Member States with the necessary national flexibility to act. At the same time, it provides appropriate safeguards to ensure that the single market and the free flow of capital are not unduly affected. These safeguards come in the form of EU coordination or authorisation requirements prior to activating the selected measures. They also encompass a reciprocation framework (mutual recognition) to avoid cross-border leakages and circumvention of measures.

In June 2019, amendments to the Capital Requirements Regulation and Directive (CRR/CRD IV) entered into force, as part of a broader overhaul of the EU's prudential and resolution rules for banks ('banking package')[60]. These reforms include a number of

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[58] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338), https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32013L0036.

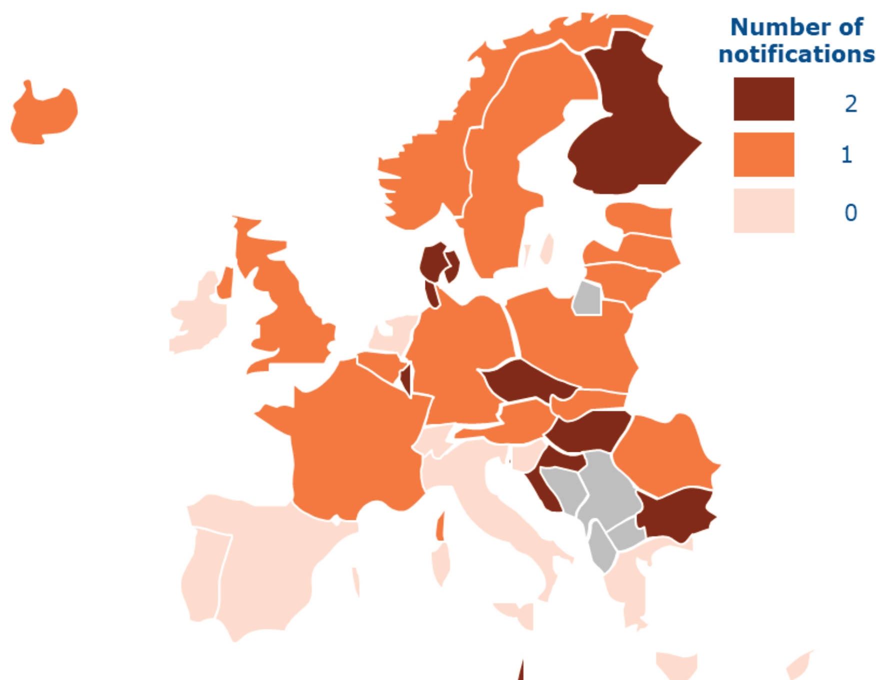
[59] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1), https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32013R0575.

[60] The banking package contains changes to the Capital Requirements Directive (Directive 2013/36/EU, OJ L 176, 27.6.2013, p. 338), the Capital Requirements Regulation (Regulation (EU) No 575/2013, OJ L 176, 27.6.2013, p. 1), the Bank Recovery and Resolution Directive (Directive 2014/59/EU, OJ L 173, 12.6.2014, p. 190) and the Single Resolution Mechanism Regulation (Regulation (EU) No 806/2014, OJ L 225, 30.7.2014, p. 1). It was published in the Official Journal on 7 June 2019 (OJ L 150 7.6.2019) and entered into force 20 days after publication, https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=OJ:L:2019:150:FULL&from=EN.

targeted improvements to the existing macroprudential provisions that will become applicable in December 2020, i.e. 18 months after the date of entry into force[61].

Several Member States have supplemented the EU laws on the macroprudential toolset for the banking sector with national macroprudential laws. Most of these national laws are for mortgage transactions, such as caps on the loan-to-value ratio, loan-to-income ratio, debt-to-income ratio, debt-service-to-income ratio and maturity limits.

Figure 10: Macroprudential measures of economic significance activated in 2019 by EEA Member States



Source: ESRB. European Commission calculations (up to October 2019).

Note: The figure only takes into account notified measures that are of economic significance. Measures of a more procedural or administrative nature, such as setting the countercyclical capital buffer rate at 0%, are not considered. Other measures that have to be notified periodically, like the yearly identification of O-SIIs and the CCyB buffer rate, are not reported if they merely serve to confirm the measures already notified. Reciprocation measures are also not regarded as being measures of economic significance.

Macroprudential measures notified by Member States mainly address three types of risks: aggregate credit growth, the systemic importance of financial institutions and the risks stemming from the real estate sector. Figure 10 provides an overview of the number of measures of economic significance per Member State, notified so far in 2019. These measures have been of a tightening nature.

First, the activation of countercyclical capital buffers (CCyB) is noteworthy. To date, nine Member States have set a non-zero CCyB rate. Eight of these Member States have

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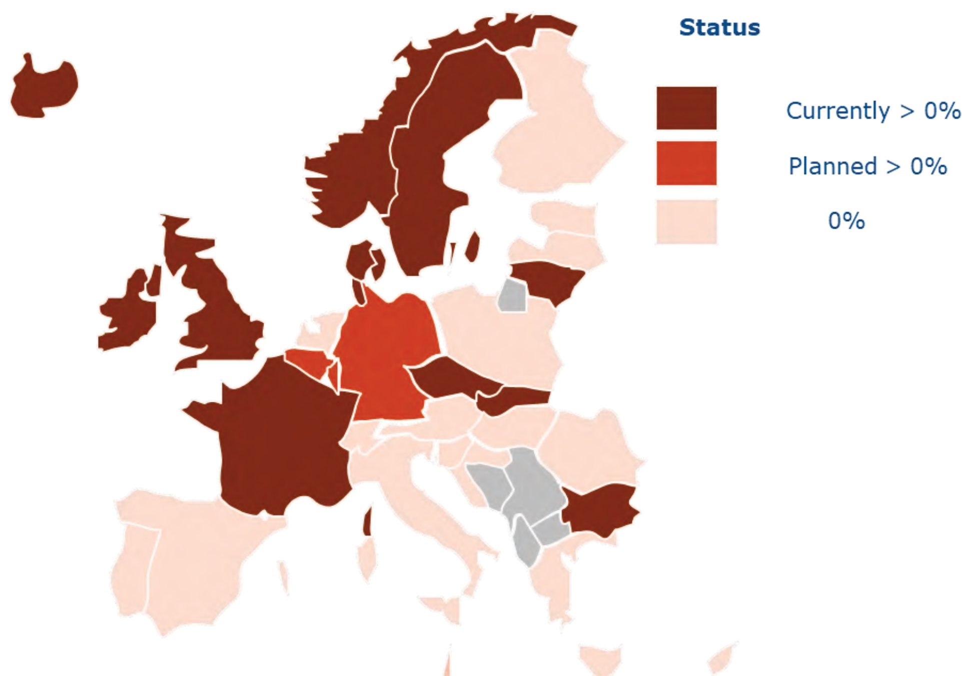
[61] The upcoming changes to the macroprudential instruments in EU banking legislation are presented in 'Upcoming changes to the macroprudential provisions in CRR/CRD4', Special Feature B, in ESRB (2019), A Review of Macroprudential Policy in the EU in 2018, April 2019.

set a non-zero CCyB rate or have increased an already positive CCyB rate in the course of 2019 (cut-off date October 2019). Five of these Member States have also announced further increases in CCyB rates. Furthermore, in 2019, three Member States announced the setting of a non-zero CCyB rate. Figure 11 summarises the activation of the CCyB.

Figure 11: Activation of the countercyclical capital buffer in 2019 by EEA Member State



Source: ESRB. European Commission calculations (up to October 2019).
Note: Bulgaria has a 0.5% CCyB since October 2019, which is scheduled to increase to 1% from July 2020. Czechia has a 1.5% CCyB since July 2019, which is scheduled to increase to 1.75% from January 2020 and to 2% from July 2020. Denmark has a 1% CCyB since September 2019, which is scheduled to increase to 1.5% from June 2020 and to 2% from December 2020. France has a 0.25% CCyB since July 2019, which is scheduled to increase to 0.5% from April 2020. Ireland has a 1% CCyB since July 2019. Lithuania has a 1% CCyB since June 2019. Slovakia has a 1.5% CCyB since August 2019, which is scheduled to increase to 2% from August 2020. Sweden has a 2.5% CCyB since September 2019. The UK has a 1% CCyB since November 2018. Belgium has announced an increase of the CCyB from 0% to 0.5% from July 2020. Germany has announced an increase of the CCyB from 0% to 0.25% from July 2020. Luxembourg has announced an increase of the CCyB from 0% to 0.25% from January 2020. Sweden has had a 2% CCyB since March 2017, which is scheduled to increase to 2.5 % from September 2019. In the EEA, Iceland has had a CCyB of 1.75% since May 2019, which is scheduled to increase to 2% from February 2020, and Norway has had a CCyB of 2 % since December 2017, which is scheduled to increase to 2.5% from December 2019.

Second, around 200 G-SIIs and O-SIIs have been identified in the EU. The additional capital buffer requirements for such institutions vary from 0% to 2% (subject to phasing-in). Decisions taken in 2019 have broadly confirmed the results of the previous years in terms of banks identified as G-SIIs and O-SIIs and in terms of calibration of the buffer requirements.

Third, by October 2019 23 Member States had activated measures to address vulnerabilities stemming from the real estate sector (cut-off date October 2019). Compared to 2018, one more Member State introduced borrower-based measures based on national law, raising the number of countries with such measures from 18 to 19. In 2019, two Member States adopted new or additional borrower-based measures or

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tightened measures already in place. Borrower-based measures appear to be relatively effective. In practice, borrower-based measures reduce vulnerabilities on the balance sheets of both banks and households, even if they mainly apply to new mortgage loans. Capital-based measures seem to have had a more indirect, limited effect on cyclical adjustments and the cost of loans. Nonetheless, vulnerabilities in the real estate sector remain a key concern in several EU Member States. In September 2019, the European Systemic Risk Board (ESRB) addressed warnings and recommendations on medium-term residential real estate vulnerabilities to 11 Member States[62]. The key vulnerabilities highlighted by the ESRB assessment relate to: (i) high or rising household indebtedness and the ability of households to repay their mortgage debt; (ii) the growth of mortgage lending and the loosening of lending standards; and (iii) the valuation or price dynamics of residential real estate.

In addition, systemic risk buffers are currently used in 14 Member States for a wide range of purposes. In 2019, two Member States (Croatia and Hungary) recalibrated their already activated systemic risk buffers, and one Member State (the United Kingdom) activated a systemic risk buffer for the first time. One Member State (Estonia) also notified a planned national measure under Article 458 CRR in 2019, while another one (Finland) notified the intention to prolong by 1 year a national measure already activated under Article 458 CRR in 2017. In each case, after giving due consideration to European Banking Authority (EBA) and ESRB opinions, the Commission refrained from proposing to the Council an implementing act rejecting the draft national measures.

Overall, the macroprudential toolset is designed to balance the need to address risks, at national level, with that of preserving the single market. A number of safeguards exist to avoid unintended consequences. However, the Commission, the ESRB and the EBA continuously monitor the use of macroprudential measures and their compatibility with the free movement of capital.

4.6 Anti-money laundering and countering the financing of terrorism

During the last year, work has continued to strengthen the EU's anti-money laundering framework. This consisted of initiatives to strengthen the supervisory aspects as well as cooperation with law enforcement authorities. The Commission also adopted several reports on the Member States' implementation of the anti-money laundering framework.

4.6.1 Increasing law enforcement authorities' access to financial information

The Directive (EU) 2019/1153[63], published on 11 July 2019, aims to improve the use of financial information by giving law enforcement authorities direct access to information

[62] https://www.esrb.europa.eu/news/pr/date/2019/html/esrb.pr190923~75f4b1856d.en.html

[63] Directive (EU) 2019/1153 of the European Parliament and of the Council of 20 June 2019 laying down rules facilitating the use of financial and other information for the prevention, detection, investigation

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about the identity of bank-account holders contained in national centralised bank registries. It also gives law enforcement authorities the possibility to access certain information from national financial intelligence units (FIUs) — including data on financial transactions — and improves the information exchange between FIUs and their access to law enforcement information that is necessary to perform their tasks. These measures will speed up criminal investigations and enable authorities to combat cross-border crime more effectively.

4.6.2 Supervision and regulatory technical standards (RTS)

4.6.2.1 European supervisory authorities review

On 12 September 2018, the European Commission amended its proposal to review the European supervisory authorities' Regulations in order to reinforce the Authorities' mandate in matters relating to preventing and combating money laundering and terrorist financing[64]. The text of the amending Regulation has been agreed by the co-legislator and was adopted on 18 December 2019[65].

This act will give a leading and coordinating role to the EBA in order to centralise resources currently scattered across the three European supervisory authorities (ESAs), thus establishing a robust support structure. The EBA will also be able to ask competent authorities to investigate possible breaches of the relevant rules and to oversee national procedures in this area. Under specific, circumscribed circumstances, it will be able to address decisions on money laundering matters directly to individual financial sector operators and engage in binding mediation between national competent authorities on such matters. .

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or prosecution of certain criminal offences, and repealing Council Decision 2000/642/JHA, https://eur-lex.europa.eu/eli/dir/2019/1153/oj.

64 COM(2018) 646 final: https://ec.europa.eu/commission/sites/beta-political/files/soteu2018-supervisory-authorities-regulation-646_en.pdf.

65 Regulation (EU) 2019/2175 of the European Parliament and of the Council of 18 December 2019 amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority), Regulation (EU) No 1094/2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority), Regulation (EU) No 600/2014 on markets in financial instruments, Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds, and Regulation (EU) 2015/847 on information accompanying transfers of funds (Text with EEA relevance) (Text with EEA relevance), OJ L 334, 27.12.2019, p. 1–145, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2019.334.01.0001.01.ENG&toc=OJ:L:2019:334:TOC.

4.6.2.2 Regulatory technical standards

As part of its legal obligation under the fourth Anti-Money Laundering Directive, the Commission has adopted Delegated Regulations on the following regulatory technical standards that have been developed by the ESAs:

- Regulatory technical standards for the minimum action and the type of additional measures credit and financial institutions must take to mitigate money laundering and terrorist financing risk in certain non-EU countries, adopted on 31 January 2019[66].
- Regulatory technical standards on the criteria for appointing central contact points for electronic money issuers and payment service providers and with rules on their functions, adopted on 7 May 2018[67].

4.6.3 Adoption of an anti-money laundering package

On 24 July 2019, the European Commission adopted a Communication to the European Parliament and the Council titled '*towards better implementation of the EU's anti-money laundering and countering the financing of terrorism framework*'[68]. It was accompanied by four reports[69]: (1) the Commission's biannual supranational risk assessment of money laundering and terrorist financing risks facing the EU's internal market; (2) an assessment of recent alleged money laundering cases involving EU credit institutions; (3) a report on cooperation between FIUs; and (4) a report on the interconnection of Member States' national centralised automated mechanisms on bank accounts.

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[66] Commission Delegated Regulation (EU) 2019/758 of 31 January 2019 supplementing Directive (EU) 2015/849 of the European Parliament and of the Council with regard to regulatory technical standards for the minimum action and the type of additional measures credit and financial institutions must take to mitigate money laundering and terrorist financing risk in certain non-EU countries (Text with EEA relevance): https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32019R0758.

[67] Commission Delegated Regulation (EU) 2018/1108 of 7 May 2018 supplementing Directive (EU) 2015/849 of the European Parliament and of the Council with regulatory technical standards on the criteria for the appointment of central contact points for electronic money issuers and payment service providers and with rules on their functions (Text with EEA relevance): https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2018.203.01.0002.01.ENG&toc=OJ:L:2018:203:TOC.

[68] COM(2019) 360 final, Communication from the Commission to the European Parliament towards better implementation of the EU's anti-money laundering and countering the financing of terrorism framework: https://ec.europa.eu/info/files/communication-commission-european-parliament-towards-better-implementation-eus-anti-money-laundering-and-countering-financing-terrorism-framework_en.

[69] Report on the assessment of the risk of money laundering and terrorist financing affecting the internal market and relating to cross-border activities (COM(2019) 370 final and Annex of 24.7.2019); report on the interconnection of national centralised automated mechanisms (central registries or central electronic data retrieval systems) of the Member States on bank accounts (COM(2019) 372 final of 24.7.2019); report on the assessment of recent alleged money laundering cases involving EU credit institutions (COM(2019) 373 final of 24.7.2019); report assessing the framework for cooperation between Financial Intelligence Units (COM(2019) 371 final of 24.7.2019).

The reports show that there are major divergences in the application of the framework. Continued action is therefore needed to ensure legislation on anti-money laundering and countering the financing of terrorism is fully, consistently and effectively implemented, notably by key competent authorities such as supervisors and FIUs. The Commission will continue to monitor the implementation of the updated legal framework and of the recommendations in its supranational risk assessment.

The report on the interconnection of national centralised bank registries concludes that the interconnection is technical feasible and that, given that a future EU-wide interconnection of the bank registries would speed up access to financial information and cross-border cooperation, the Commission intends to further consult with relevant stakeholders, governments, as well as FIUs, law enforcement authorities and asset recovery offices as potential end-users of a possible interconnection system. For an interconnection to be achieved a legislative proposal would be required.

The reports also identify structural shortcomings that have not yet been addressed.

Finally, the reports recommend that the Commission consider further harmonising the rulebook on anti-money laundering and countering the financing of terrorism. One option would be transforming the Anti-Money Laundering Directive into a Regulation, conferring specific anti-money laundering supervisory tasks to an EU body, and having a stronger mechanism to coordinate and support cross-border cooperation and analysis by FIUs.

4.6.4 EU list on high-risk non-EU countries

Under Directive (EU) 2015/849, the Commission is required to adopt a delegated act setting out the list of high-risk non-EU countries that have strategic deficiencies in their anti-money laundering/countering the financing of terrorism (AML/CFT) regimes.

The Commission adopted a first Delegated Regulation on 14 July 2016 listing 11 jurisdictions in line with the assessment also made by the Financial Action Task Force (FATF) — the international standard setter in the field. The Commission successively amended this list in order to reflect the latest available information.

Using its scrutiny powers, the European Parliament rejected some of those delegated acts that updated the EU list — requesting that the Commission make a more autonomous assessment that does not exclusively rely on FATF lists. The Commission confirmed on 29 June 2017 that it would work towards a more autonomous assessment methodology to identify jurisdictions that have strategic deficiencies in tackling ML/TF. This approach was confirmed by the legislator when adopting the fifth Anti-Money Laundering Directive (May 2018) which provides for a wider set of criteria for autonomous assessments.

On 22 June 2018, the methodology for identifying high-risk non-EU countries was issued, supporting an objective, fair and transparent listing process[70]. The methodology

[70] https://ec.europa.eu/info/files/methodology-high-risk-third-countries_en

provides that the Commission will consider any non-EU country identified by the FATF as having strategic deficiencies as high-risk. This baseline will also be complemented by an autonomous EU assessment based on the criteria set in the Anti-Money Laundering Directive.

On 13 February 2019, the Commission adopted a new delegated act based on the new methodology[71], listing 23 'high-risk third countries' in the area of money laundering and terrorist financing.

On 7 March 2019, the Council unanimously decided to reject this delegated act on procedural grounds as '*not established in a transparent and resilient process that actively incentivises affected countries to take decisive action while also respecting their right to be heard*'. On 14 March 2019, the European Parliament adopted a resolution commending the work done by the Commission, regretting the Council rejection and encouraging the Commission to come up with a new delegated act as soon as possible[72].

The Commission Services are now working on a refined methodology that strengthens the engagement with non-EU countries.

In any case, the inclusion of a country on the list of high-risk non-EU countries does not trigger economic or diplomatic sanctions, but, rather, requires 'obliged entities' such as banks, casinos and real estate agencies to apply enhanced due diligence measures on transactions involving these countries, and to make sure that the EU financial system is equipped to prevent money laundering and terrorist financing risks coming from these non-EU countries.

4.6.5 Application of the Regulation on information accompanying transfers of funds

On 19 June 2019, the European Commission adopted its mandatory report on the implementation of Regulation (EU) 2015/8471 on information accompanying transfers of funds[73], which imposes a set of obligations on payment service providers with regard to the information on payers and payees that has to accompany transfers of funds.

The Commission found Member States' implementation of the sanctions part of the Regulation to be of an overall satisfactory quality. However, the report identified some shortcomings and underlined the need to eliminate all legal loopholes.

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71 https://ec.europa.eu/info/files/commission-delegated-regulation-c-2019-1326-supplementing-directive-eu-2015-849-european-parliament-and-council-identifying-high-risk-third-countries-strategic-deficiencies_en

72 P8_TA(2019)0216: https://www.europarl.europa.eu/doceo/document/B-8-2019-0176_EN.html.

73 Regulation (EU) 2015/847 of the European Parliament and of the Council of 20 May 2015 on information accompanying transfers of funds and repealing Regulation (EC) No 1781/2006, OJ L 141, 5.6.2015, p. 1-18: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM:2019:282:FIN.

On the application of the relevant provisions of the Regulation, no major deficiencies were identified. Modest sanctions and investigatory activities under the Regulation could be carried out if payment service providers comply with their legal obligations, but longer-term monitoring is needed to eliminate any potential weaknesses of the supervision framework.

5 GLOBAL DEVELOPMENTS IN CAPITAL MOVEMENTS/PAYMENTS

5.1 Free trade agreements and stand-alone investment agreements

Following the entry into force of the Lisbon Treaty, which gave the EU exclusive competence for FDI (Article 207 TFEU), the Commission engaged in an ambitious negotiation agenda that covers investment liberalisation and investment protection as well as investment dispute settlement in free trade agreements or stand-alone investment agreements.

The investment protection provisions typically cover a number of standards of treatment to be afforded to investors of one party and their investments in the territory of another party. These include non-discrimination, fair and equitable treatment, prohibition of expropriation without compensation and free transfer of funds, and the possibility for dispute settlement between investors and states. However, some of these provisions have raised concerns in the past about how they might interfere with the right of states to regulate. Against this background, the Commission adopted a reform-based approach, which entails modern and innovative provisions to ensure a balance between investors' rights and states' right to regulate on legitimate public policy objectives. The Commission applies this approach in all its negotiations on investment protection provisions.

In 2019, the negotiations intensified on the stand-alone investment agreement with China. Six rounds of negotiations took place in 2019, focusing mainly on commitments related to liberalisation and market access offers. In April 2019 at the 21st EU-China Summit, the two sides committed to achieve in the course of 2019 the decisive progress required — notably on the liberalisation commitments — for the conclusion of an ambitious EU-China Comprehensive Investment Agreement in 2020.

The free trade agreement with Japan entered into force in February 2019. Discussions continue on investment protection and investment dispute settlement as part of a possible future investment protection agreement.

The EU-Singapore free trade and investment protection agreements were signed in October 2018 and approved by the European Parliament in February 2019. The EU-Vietnam free trade and investment protection agreements were signed on 30 June 2019 and have been presented to the European Parliament for consent. Both investment protection agreements will also require ratification by the Member States in line with their respective internal procedures.

The negotiations on a modernised trade part of the EU-Chile Association Agreement, which includes a chapter on investment liberalisation and protection, advanced in the

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course of 2019 (three negotiating rounds took place in May, July and November 2019), and will continue in 2020.

On 12 June 2019 a political agreement for an ambitious, balanced and comprehensive trade agreement with Mercosur was reached. The text is now subject to legal revision, and after translation into official EU languages will be submitted to Member States and the European Parliament for approval.

The negotiations with Indonesia are ongoing. The latest round took place in Brussels in December 2019 and the next one should take place around March/April 2020 in Indonesia. With regard to the investment provisions being negotiated, both liberalisation and protection are covered.

On 18 and 21 June 2018, the EU launched negotiations on free trade agreements with Australia and New Zealand respectively. Both negotiations cover investment liberalisation, including the free movement of capital and payments, but do not cover investment protection. In 2019, there have been three rounds of negotiations with New Zealand (February, May and December) and two with Australia (in March and October). The negotiations on the investment liberalisation chapter in the future free trade agreements (FTAs) with both countries are quite advanced and will continue in 2020.

The negotiations of a Deep and Comprehensive Free Trade Area (DCFTA) with Tunisia cover investment liberalisation and investment protection. The latest negotiation round took place at the beginning of May 2019.

5.2 Member State bilateral investment treaties with non-EU countries

As a general rule, the agreements on investment protection negotiated at EU level with various non-EU countries replace the bilateral investment agreements concluded by Member States with the same countries. However, under Regulation (EU) No 1219/2012 establishing transitional arrangements for bilateral investment agreements between Member States and non-EU countries, the Commission can still authorise Member States to negotiate or conclude new bilateral investment agreements under certain conditions, namely there may be no EU level negotiation with the same country ongoing (or decided), and the agreement must be compatible with EU law and consistent with EU investment policy.

The Commission takes its decision on the basis of a notification by the interested Member State after consulting the other Member States in a comitology procedure.

5.3 Investment screening

The EU has one of the world's most open investment regimes, and collectively the Member States have the fewest restrictions on FDI in the world. This is expressly acknowledged in the OECD FDI Regulatory Restrictiveness Index, which measures statutory restrictions on foreign direct investment in 62 countries worldwide and how they have changed since 1997. However, in some cases foreign investors might seek to acquire strategic assets allowing them to access, for example, critical technologies, infrastructure or sensitive information, posing some risks to security or public order. In

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response to such concerns, a number of Member States have introduced 'investment screening mechanisms', while at EU level the Regulation establishing a framework for screening of FDI into the EU was adopted, putting in place EU-wide cooperation on screening. While capital controls and capital flow management measures aim to prevent disorderly outflows from causing a financial and economic meltdown, investment screening mechanisms enable the public authorities to review and, if necessary, prevent inward investments on grounds of security or public order.

5.3.1 Member States' screening mechanisms

According to the notifications by the Member States[74], 15 of them have set up mechanisms to screen investment in order to safeguard public security or public policy interests (Denmark, Germany, Spain, France, Italy, Latvia, Lithuania, Hungary, the Netherlands, Austria, Poland, Portugal, Romania, Finland and the United Kingdom). Most of these mechanisms apply to both intra-EU/EEA and extra-EU/EEA investors, while others apply to extra-EU/EEA investors only. Some mechanisms identify sectors in which investments are subject to screening, while others are not limited to specific sectors or list sectors for illustrative purposes only. The screening mechanisms provide for thresholds (e.g. acquisition of 25% of share capital/voting rights or control in a company) to identify the investments to be screened, which normally exclude portfolio investment. They can be triggered by voluntary or mandatory notifications and, under certain conditions, the public authority may initiate a review on its own initiative. Depending on this, the review may take place before the investment is completed (ex-ante) or after the completion of the investment (ex-post).

In the reporting period, the following developments were observed in national investment screening frameworks:

The Hungarian screening mechanism[75] entered into force on 1 January 2019. The screening law introduces an obligation of prior notification and authorisation for acquisitions by non-EU/EEA investors of shareholding or control above certain thresholds in companies operating in the following sectors: manufacture of weapons and ammunition, dual-use goods, military activity, financial services, public utilities (electricity, natural gas and water), electronic communication, and information security of the state and municipalities.

France amended its screening mechanism by Decree 2018-1057 of 29 November 2018 on foreign investments subject to prior approval[76], which entered into force on 1 January 2019. The Decree expands the sectors covered by screening, enlarges the reasons for

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[74] List of screening mechanisms notified by Member States, last update: 12 December 2019 https://trade.ec.europa.eu/doclib/docs/2019/june/tradoc_157946.pdf.

[75] Act LVII of 2018 on controlling foreign investments violating Hungary's security interests, unofficial translation available at: https://trade.ec.europa.eu/doclib/docs/2019/june/tradoc_157938.pdf.

[76] Available at: https://www.legifrance.gouv.fr/eli/decret/2018/11/29/ECOT1816712D/OJ/texte.

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refusing an authorisation to invest and expressly allows a target company to enquire in advance if the envisaged investment would be covered by the screening rules. In May 2019, France passed a law to support the growth and transformation of firms (known as the 'loi PACTE')[77]. The law introduces diverse measures to improve the business environment by further reducing barriers that limit the creation and growth of firms. Among other things, it revises the sanctioning regime of the screening mechanism and sets additional transparency requirements. The law also expands the golden shares regime in France ('actions spécifiques'), essentially by making it possible for the state to issue golden shares independently from selling stakes, and extending the number of strategic companies for which the state can decide to introduce such shares.

Italy has amended its investment screening framework by Decree Law No 22/2019 of 25 March 2019[78], which includes components and contracts related to 5G telecommunications in the scope of its screening mechanism.

Following an infringement procedure for non-compliance with internal market freedoms, Croatia adopted on 20 February 2019[79] a new prior authorisation mechanism for the acquisition of shares in the energy company INA-Industrija nafte, d.d. It allows the government to screen investments in the company above certain thresholds and to oppose the acquisition in case of 'a serious threat to public safety and an exceptional risk of serious damage to public safety in a way that would jeopardise the secure, reliable and regular supply of energy and the protection of the safety of energy supply infrastructure'. The mechanism is accompanied by other measures that enable the government to monitor compliance with the stated objectives after the investment is made.

Finally, Finland in March 2019 adopted a mechanism for mandatory prior approval of acquisitions of real estate by investors from non-EU/EEA countries. It has also adopted the law that provides the State with the pre-emptive right in real estate transactions in the immediate vicinity of strategic sites. Both laws entered into force on 1 January 2020[80].

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[77] Loi No 2019-486 du 22 mai 2019 relative à la croissance et la transformation des entreprises, see Articles 152-154, available at: https://www.legifrance.gouv.fr/affichTexte.do?cidTexte=JORFTEXT000038496102&dateTexte=20190910.

[78] Decreto-Legge No 22/2019 of 25 March 2019, passed into law on 13 May 2019, available at: https://www.gazzettaufficiale.it/atto/serie_generale/caricaDettaglioAtto/originario?atto.dataPubblicazioneGazzetta=2019-03-25&atto.codiceRedazionale=19G00032&elenco30giorni=true.

[79] Act amending the Act on privatisation of INA, published in the Croatian OJ on 1 March 2019: https://narodne-novine.nn.hr/clanci/sluzbeni/2019_03_21_437.html.

[80] Law 470/2019, available at https://www.finlex.fi/fi/laki/alkup/2019/20190470, and Law 469/2019, available at: https://www.finlex.fi/fi/laki/alkup/2019/20190469. See also: https://www.defmin.fi/en/topical/permission_to_non-eu_and_non-eea_buyers_to_buy_real_estate.

5.3.2 EU framework for screening of extra-EU investment

The Regulation (EU) 2019/452 establishing a framework for screening of FDI into the EU was adopted on 19 March 2019. It was published in the Official Journal (OJ) on 21 March, and entered into force on 10 April 2019. It will be fully applicable as of 11 October 2020.

The EU screening framework is designed to help all Member States and the Commission to identify and effectively mitigate possible risks that certain foreign investments may pose to security and public order, regardless of whether a Member State has a screening mechanism or not. The EU screening framework does not replace (or duplicate) screening mechanisms maintained currently by 15 EU Member States. It puts in place a cooperation mechanism, where Member States and the Commission would be able to exchange information on FDI likely to affect security or public order interests, and — when justified — to raise concerns (issue non-binding opinions) regarding such FDI. The Commission opinion will have a stronger impact, when projects or programmes of EU interest could be affected on security or public order grounds, as Member States will have to take utmost account of the Commission opinion, and justify if such opinion is not followed.

The Regulation provides a non-exhaustive list of factors that may be considered when screening FDI. Factors include the impact of investments on: (i) critical infrastructure, e.g. energy, transport, health, defence and financial; (ii) critical technologies, such as dual-use, artificial intelligence, robotics and cybersecurity; (iii) security of supply of critical inputs; (iv) access to sensitive information; and (v) freedom and pluralism of media. Factors that are specific to an investor may also be considered, e.g. whether they are controlled by a foreign government, whether they have been involved in activities affecting security or public order, or whether there is a serious risk that they engage in illegal or criminal activities.

5.4 Free movement of capital and the OECD

In May 2019, the OECD Council approved the review of the OECD Code of Liberalisation of Capital Movements. This Code commits its adherent countries to progressively liberalise cross-border capital flows[81]. The main objective of the review was to strengthen the Code by ensuring that it remains relevant in an environment that has substantially changed over the past decades. The Commission participated actively in the review and has introduced additional coordination among Member States to ensure that their positions are consistent, in particular on matters that are covered by a common legal framework in the EU.

The reviewed Code ensures that adherent members can take measures necessary to preserve financial stability ('macroprudential measures') while preserving liberalisation standards. It clarifies that widely used macroprudential measures are not considered

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[81] https://www.oecd.org/daf/inv/investment-policy/codes.htm

restrictions (currency-based Basel III-type liquidity ratios such as the liquidity coverage ratio and the net stable funding ratio). It also provides flexibility for untested measures, acknowledging that the macroprudential toolkit is evolving.

Other important outcomes of the review include:

- *Improvement of the assessment process of measures taken by adhering countries*: clearer criteria for the conformity assessment of measures, stronger role of the OECD Secretariat in monitoring country measures, clearer deadlines for notification and prompt declassification of reports on assessment of measures;

- *Closer cooperation of other international organisations*: consulting other international organisations, in particular the IMF for its expertise on balance of payment issues, is now explicitly allowed. This is of particular importance to address any compatibility issue that could arise with the IMF Institutional View[82];

- *More effective decision-making*: a country being under review may not block the conclusion of the assessment of country-specific measures.

5.5 Economic and financial sanctions for non-EU countries

The possibility of applying restrictive economic and financial measures is one of the general exceptions to the free movement of capital and payments in relation to non-EU countries. Pursuant to Article 215 of the TFEU, restrictive economic and financial measures may be taken against non-EU countries, or individuals, groups or non-state entities. Such measures are based on decisions adopted in pursuit of the objectives and within the legal framework of the common foreign and security policy[83].

The restrictions applied by the EU usually take the form of freezing the assets (funds and economic resources) of a specific person, entity or body, and sectorial measures, such as the ban on providing financial assistance for military activities, but many other measures are possible. The EU sanctions map[84] provides detailed information on the current restrictive measures [85].

In 2019 three new sanctions regimes were put in place. Under Council Regulation (EU) 2019/796 the Council can freeze the funds and economic resources of natural or legal persons, entities and bodies who are responsible for cyber-attacks and of those providing

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[82] The IMF's Institutional View on capital flows provides a macroeconomic framework for consistent policy advice on liberalising and managing capital flows, with the goal of helping countries harness the benefits of capital flows while managing the risks: https://www.imf.org/external/np/g20/pdf/2018/073018.pdf.

[83] See Article 29 TEU on the approval of such a decision.

[84] www.sanctionsmap.eu

[85] The EU Sanctions Map is an information tool. Note that the EU Official Journal is the official source of EU law and, in case of conflict, its content prevails over that of the EU Sanctions Map.

support to them. Two new geographic sanctions regimes concern Nicaragua[86] and Turkey's unauthorised drilling activities in the Eastern Mediterranean[87]. For the time being no persons, entities or bodies have been listed under these regimes.

During the reporting period, most existing EU sanctions regimes were renewed for further six-month periods, including the regimes established in view of Russia's actions destabilising the situation in Ukraine and North Korea's nuclear proliferation activities. One sanctions regime was repealed during the same period[88].

The most prominent of the EU's existing sanction regimes during the reporting period were those relating to Russia's actions in Ukraine[89]. In addition to targeted individual restrictive measures like asset freezes against certain individuals and entities linked to the undermining of the territorial integrity of Ukraine, economic sanctions were first introduced on 31 July 2014. They include restrictions targeting Russian interests in the financial, oil and defence sectors. The EU's restrictive financial measures aim to cut off strategic state-owned Russian companies from EU financing sources, thus imposing an indirect financial cost on the Russian state in order to induce a change in behaviour. In March 2015, the European Council linked the lifting of EU sanctions to the implementation of the Minsk peace agreements. The sanctions have been rolled over by a Council decision every half year since their introduction. On 27 June 2019, the Council prolonged the economic measures until 31 January 2020.

The most far reaching EU sanctions regime in terms of the complexity of the financial and capital restrictions imposed is the one against North Korea on account of its nuclear proliferation activities[90]. The regime prohibits the transfer or clearing of funds to and from North Korea, as well as any transactions with banks domiciled in North Korea or the opening of branches and subsidiaries of North Korean banks in the EU and of EU banks in North Korea. It also requires that Member States step up monitoring of the

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[86] Council Decision (CFSP) 2019/1720 and Council Regulation (EU) 2019/1716 of 14 October 2019 concerning restrictive measures in view of the situation in Nicaragua.

[87] Council Decision (CFSP) 2019/1894 and Council Regulation (EU) 2019/1890 of 11 November 2019 concerning restrictive measures in view of Turkey's unauthorised drilling activities in the Eastern Mediterranean.

[88] Council Regulation (EU) 2019/985 of 17 June 2019 repealing Regulation (EU) 2018/1001 concerning restrictive measures in view of the situation in the Republic of Maldives.

[89] Council Decision (CFSP) 2014/145 and Council Regulation (EU) 269/2014 of 17 March 2014 concerning restrictive measures in respect of actions undermining or threatening the territorial integrity, sovereignty and independence of Ukraine, and Council Decision (CFSP) 2014/119 and Council Regulation (EU) 208/2014 of 5 March 2014 concerning restrictive measures directed against certain persons, entities and bodies in view of the situation in Ukraine.

[90] Council Decision (CFSP) 2016/849 of 27 May 2016 concerning restrictive measures against the Democratic People's Republic of Korea and repealing Decision 2013/183/CFSP, and Council Regulation (EU) 2017/1509 of 30 August 2017 concerning restrictive measures against the Democratic People's Republic of Korea and repealing Regulation (EC) No 329/2007.

activities of their financial institutions relating to North Korean banks, as well as detailed reporting by EU banks on such activities.

Independent from the EU sanctions regimes, unilateral restrictive measures adopted by non-EU countries with extraterritorial impacts on EU operators have disruptive effects on the free movement of capital and payments within the EU.

The European Union does not recognise the extra-territorial application of laws adopted by third countries and considers such effects to be contrary to international law. In this context, the purpose of the European Union's Blocking Statute (Council Regulation (EC) No 2271/96) is to protect EU operators from the extra-territorial application of third country laws by nullifying the effect in the EU of any foreign court ruling based on the foreign laws listed in its Annex, and by allowing EU operators to recover in court damages caused by the extra-territorial application of the specified foreign laws.

6 CONCLUSIONS

Supporting the free movement of capital and facilitating cross-border capital flows ensure that the EU attracts much needed investments to sustain its economy and labour market. It also ensures a safe and stable financial system with proper risk sharing — a system that channels funds to the businesses and individuals that need them the most and can make the best use of them.

In 2018, capital flows decreased. This included foreign direct investment (FDI), which is seen as one of the most stable and beneficial forms of investment. A closer look at the flows reveals that FDI transiting through the EU (originating from outside the EU and going outside the EU) might be responsible for a large part of this decline. This suggests that 'genuine' investment that benefits and remains in the EU is mostly stable.

However, in the current context of slowing economic growth and global trade tensions, there is a pressing need for more closely integrated capital markets in the EU. Significant progress has been made on the Capital Markets Union (CMU), but it is time to reflect on how to extend it further. To this end, the High-level Forum on capital markets is consulting with market participants, civil society and academics with a view to proposing targeted policy recommendations for future CMU actions.

The EU has set ambitious political priorities for the coming years, including being the first climate-neutral continent, being fit for the digital age and supporting our small and medium-sized enterprises, which are the backbone of the European economy. Meeting these objectives will require massive investment. Public finances will not be enough, so channelling private investment and mobilising cross-border investments is crucial. The remaining barriers to the free movement of capital clearly need to be brought down, and with the bilateral investment treaties between Member States coming to an end, it is crucial that investors continue to feel confident that their investments are effectively protected.

The EU remains open to investment from non-EU countries and continues to negotiate free trade and investment agreements with its international partners to attract capital

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flows. The EU also works together with international organisations such as the OECD to encourage others to become more open to capital movements, and to ensure that the international framework for free movement of capital is consistently applied. However, far from being a naïve free trader, the EU strives to protect its strategic interests. For example, to ensure scrutiny over purchases by foreign companies that target Europe’s strategic assets, the EU adopted in 2019 a framework for screening investments that will help identify and effectively mitigate possible risks of certain foreign investments.

The EU will build on this framework and the other 2018-2019 CMU-related policies outlined in this report, to ensure that the EU meets the challenges of climate change and adapting to the digital age, and that people and businesses in the EU continue to reap the benefits of safe, open and efficient European financial markets.

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