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PRELIMINARY REFERENCE C-452/04 FIDIUM FINANZ (cross border provision of financial services originating from a non-EU Member State versus free movement of capital)

1. Introduction

This note aims to inform about an interesting case on cross border financial services between the BaFin and a Swiss consumer credit company that has been recently referred to the European Court of Justice (ECJ) by a German court - Verwaltungsgericht (the Administrative Court), Frankfurt am Main. The preliminary reference was lodged on 29 October 2004. The referring court seeks to obtain the ECJ's clarification regarding the proper interpretation of the applicability of Articles 56 (free movement of capital) and 49 (freedom to provide services) of the Treaty where consumer credits are provided to residents of an EU Member State (Germany) via the internet or through credit intermediaries operating in the EU by a company registered outside the EU (Switzerland) and where the consumer credit company is not subject to (a) supervision by the Swiss Banking Commission, because it does not engage in deposit activities, nor (b) authorisation to grant or to negotiate consumer credits by the relevant Swiss cantonal authorities, because it does not negotiate and grant loans in Switzerland.

2. Summary of case

The plaintiff, Fidium Finanz AG (Fidium Finanz), is a joint stock company established in St Gallen, Switzerland, which has made small-scale loans of money (EUR 2500–3500) to customers predominantly domiciled in Germany since 1987. Fidium Finanz challenges the order issued by the defendant (Bundesanstalt für Finanzdiensteleistungsaufsicht or BaFin) to cease granting loans of money to customers domiciled in Germany and to wind up the credit transactions which have already been effected. In Switzerland Fidium Finanz is not subject to supervision of the Swiss Banking Commission, because it does not engage in deposit activities. Since 1 January 2004 Swiss cantons must make the granting and negotiating of customer credits subject to authorisation in accordance with the Swiss Consumer Credit

Law. Such authorisation is subject to the applicant being reliable and being in sound financial circumstances, having the general business and professional knowledge and skills necessary to operate as a lender or credit intermediary and having adequate professional insurance. On 28 June 2004 the Canton of St Gallen informed the Bafin that Fidium Finanz did not have authorisation to grant or to negotiate credit, as it does not negotiate and grant loans in Switzerland.

Fidium Finanz offers credits in Germany (1) via the internet and (2) through credit intermediaries operating in Germany, the intermediary being neither a representative nor authorised agent of the Fidium Finanz in accordance with agreements Fidium Finanz has concluded with the intermediaries.

On 12 April 2003 BaFin published new instructions concerning the obligation to obtain authorisation for cross-border banking activities under Paragraph 32(1) of the Law on Credit Institutions (KWG)[1]. As a consequence undertakings such as Fidium Finanz were required to have an authorisation to engage in banking business.

By decision of 22 August 2003 the BaFin prohibited the Fidium Finanz from engaging in credit activities whereby the Fidium Finanz would grant loans of money to customers domiciled in Germany. Fidium Finanz was also ordered to wind up credit activities it was currently engaged in and prohibited from advertising loans targeting German customers. After an unsuccessful administrative appeal (BaFin decision of 18 February 2004), Fidium Finanz brought an action to the Verwaltungsgericht seeking the annulment of the decisions adopted against it.

Fidium Finanz argues that it does not engage in banking activities 'in Germany' as required by Paragraph 32(2) of the KWG[2] for an authorisation requirement to exist. Fidium Finanz maintains that its business activities in Germany are not localised to a sufficient degree. Furthermore, Fidium Finanz argues that the broad interpretation by BaFin of the provisions of the scope of authorisation requirements is inadmissible due to the content of criminal offence set out in Paragraph 54 of the KWG.[3] Further, Fidium Finanz invokes the argument that the assumption that it is under the obligation to obtain authorisation also infringes the free movement of capital guaranteed by Article 56 of the Treaty and is not justified under Article 58(1)(b), which provides *inter alia* that the provisions on the free movement of capital are without prejudice to the right of Member States to take all requisite means to prevent infringements of national law and regulations, in particular in the field of the prudential supervision of financial institutions. Finally, Fidium Finanz claims that BaFin's decision fails to fulfil Germany's obligation arising under the

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[1] '***32. Granting the licence***
(1) Anyone wishing to conduct banking business or to provide financial services in Germany commercially or on a scale which requires a commercially organised business undertaking requires a written licence from the Federal Financial Supervisory Authority; section 37 (4) of the Act on Administrative Procedures (Verwaltungsverfahrensgesetz) applies.'

[2] Reference to Paragraph 32(2) appears to be a mistake, because 32(2) does not contain such wording. The correct reference seems to be Paragraph 32(1). For the exact wording see previous footnote.

[3] '*54. Prohibited business, operating without a licence*
(1) Anyone who
1. conducts business which is prohibited under section 3, read also in conjunction with section 53b (3) sentence 1 or 2, or
2. conducts banking business or provides financial services without the licence required under section 32 (1) sentence 1, shall be punished by a term of imprisonment not exceeding three years or by a fine.
(2) If the culprit behaves in this way through negligence, the punishment shall be a term of imprisonment not exceeding one year or a fine'.

GATS (General Agreement on Trade and Services), whereby persons established in Germany are expressly guaranteed the right to obtain credit from foreign providers.

The BaFin claims that it is necessary for the credit sector as a whole that there should be sound business practices throughout the sector and that the obligation to obtain authorisation serves to safeguard this important aim. Further, the BaFin indicates that the rules concerning branches and the privileges for undertakings in other Member States laid down in the provisions of the KWG[4] merely modify the obligation to obtain authorisation which exists in principle. BaFin emphasises that foreign undertakings having their registered offices outside the EEA which maintain a branch in a Member State cannot be treated better then undertakings having their registered offices within the EEA. According to BaFin, Fidium Finanz seeks to obtain such better treatment since, on the one hand, it wishes to avoid the supervision of the German authorities and, on the other, it is not subject to any supervision in the country in which it has its registered office. Finally, with regard to the GATS BaFin contends that market access in respect of financial services of the kind provided by Fidium Finanz is not guaranteed by the GATS.

3. Questions referred to the ECJ by the Verwaltungsgericht of Frankfurt am Main for preliminary ruling (summary[5] and comments)

1) Can an undertaking having its registered office outside the EU (i.e. Switzerland) rely on the freedom of movement of capital under Article 56 of the Treaty in respect of the commercial grant of credit to residents of an EU Member State, or are its activities covered solely by the freedom to provide services under Article 49 of the Treaty?

The ECJ's answer to this question can be of particular importance to determine the rights of a third country company offering financial services in the EU without being established in the EU. Indeed Article 49 of the Treaty providing for the free movement of services applies only to EU nationals while Article 56 establishing the free movement of capital applies also to third countries' nationals. Until now the ECJ has not established clear-cut criteria allowing to identify the border between these two fundamental freedoms. This case could bring the ECJ to clarify the scope of the two freedoms taking into account that free movement of services has a residual character in accordance with Article 50 of the Treaty, (i.e. services shall be considered to be 'services' within the meaning of the Treaty in so far as they are not governed by the provisions relating to freedom of movement for goods, capital and persons).

2) Can an undertaking having its registered office outside the EU rely on the freedom of movement of capital under Article 56 of the Treaty where it grants loans commercially or predominantly to residents domiciled within the EU and has its registered office in a country where it is not subject, in relation to the taking up and conduct of that business activity, to the requirement of prior authorisation by a State authority of that country or the requirement of regular supervision of its business activity in a manner

[4] Paragraph 53 et seq.

which is customary to credit institutions within the EU, and in this particular case, within Germany, or does reliance on freedom of movement of capital in such a case constitute a misuse of the law?

Can such an undertaking be treated, in relation to the law of the European Union, in the same way as persons and undertakings established in the territory of the relevant Member State as regards the obligation to obtain the authorisation even though it does not have its registered office in that Member State and also does not maintain a branch there?

It is noted that already from mid-1970s the ECJ has followed the case law[6] that a Member State has the right to take measures to prevent the abusive exercise by a person providing services whose activities are entirely or principally directed toward its territory of the Treaty provisions on the freedom to provide services for the purpose of avoiding the professional rules of conduct which would be applicable to him if he were established within that Member State. However, never before has the ECJ considered the application of this 'U-turn' case law to third country companies benefiting from the free movement of capital under Article 56 of the Treaty.

3) Does an obligation to obtain the authorisation applicable to an undertaking which grants credits commercially to residents of a Member State and has its registered office outside the EU constitute a barrier to the free movement of capital under Article 56 of the Treaty?

4) Is the prior authorisation requirements referred to in Question 3 justified by Article 58(1)(b)7 of the Treaty?

5) Does Article 58(1)(b) cover the formulation of an authorisation requirements permissible per se under Community law – in the sense of question 3?

It is further noted that the KWG contains different provisions regarding the definition of the credit institution than Directive 2000/12/EC relating to the taking up and pursuit of the business of credit institutions. Article 1(1) of Directive 2000/12/EC defines as credit institutions only those undertakings *'whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account'*. In accordance with the KWG, however, banking activities are engaged in where just one of the eleven definitions set out in Paragraph 1(1) of the KWG is met. '*Granting of money loans and acceptance credits (lending business)*' is cited among these eleven definitions. Nevertheless, while referring the question to the ECJ, the Verwaltungsgericht does not seek to clarify whether this more demanding nature of German law governing the activities of credit institutions is of importance in the

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[5] A summary of the preliminary reference published in the OJ C 6/29 containing the questions referred to the ECJ by the Verwaltungsgericht is attached.

[6] Case 33/74 Van Binsbergen v Bedrijfsvereniging voor de Metallnijverheid [1974] ECR 1299 and Case 52/79 Procureur du Roi v Debauve [1980] ECR 833.

[7] '*The provisions of Article 56 shall be without prejudice to the right of Member States:*
(b) to take all requisite measures to prevent infringements of national law and regulations, in particular in the field of taxation and the prudential supervision of financial institutions, or to lay down procedures for the declaration of capital movements for purposes of administrative or statistical information, or to take measures which are justified on grounds of public policy or public security.'

context of this case, although it analyses this difference between the EU law provisions and German legislation.