European Banking Federation

EBF Key Information Document
Financial Transaction Tax

April 2013

The Voice of Europe's Banks

Launched in 1960, the European Banking Federation (EBF) is the voice of the European banking sector from the European Union and European Free Trade Association countries. The EBF represents the interests of almost 4,500 banks, large and small, wholesale and retail, local and cross-border financial institutions. Together, these banks account for over 80% of the total assets and deposits and some 80% of all bank loans in the EU.

Background information

On 14 February 2013, the Commission put forward a proposal for a Council Directive to implement a Financial Transaction Tax (FTT) via the enhanced cooperation procedure (ECP) in which 11 Member States are participating. Non-participating Member States will be able to contribute to discussions on the FTT text, but the final vote will be restricted to participating Member States (MS) from which it will require unanimity.

The proposed FTT legislation focuses on financial institutions (FIs), which it broadly defines. The tax chargeable event is the execution of a financial transaction involving a FI connected to the FTT zone (the 11 MS). This connection is based on a number of factors including an establishment criterion and an issuance principle. The interested FI will have primary responsibility for the payment of the FTT to its local tax authorities, even if there is, in principle, a joint liability of each party to the transaction. So far, it is unclear how the FTT will be collected in practice.

The Commission has opted for a broad-based approach, including in the scope of the FTT scheme, all kinds of financial instruments and financial transactions. The proposal provides for few carve-outs, ring-fencing SMEs and private households, primary markets, issuing of government bonds, as well as monetary policy instruments and post-trading activities.

As regards financial instruments other than derivatives, each participating Member State will fix the tax rate at 10 basis points at minimum. This headline rate will be applied to the amount paid for the transfer or to the market price if it is higher. For derivatives, a headline rate of 1 bp will apply to notional amounts.

Summary of EBF analysis

Under the current proposal, the magnitude and scope of the FTT are far reaching:

- The FTT will apply to a **broad population of FIs and to a very large range of products** and transactions. No exemption is provided by nature of actors (e.g. market-makers are in scope); either by nature of products (the purchase of government bonds and the conclusion of derivatives are taxable), or by nature of transactions (repos are in scope).
- The **cascading effect** makes the effective rate of the FTT on securities much higher than the headline rate of 0.1% - perhaps ten times higher. The reason is the chain of trading and clearing that lies behind most securities transactions. Indeed, a purchase of securities on a stock exchange ordinarily involves the sale and purchase by a number of parties, including market makers, brokers, clearing members and the central counterparty to the clearing system. Each sale will be subject to the FTT, with only the central counterparty being exempt.
- Financial institutions around the world will continue to seek to execute transactions at the lowest possible cost. Given the **extraterritoriality** of the scheme, the imposition of a FTT on transactions executed with financial institutions within FTT jurisdictions will deter persons outside the FTT zone from doing business with such financial institutions.

Objectives' analysis

As currently designed, the proposal would meet virtually none of its objectives. Worse still, it would have a significant negative impact on the financial sector, and hence the European economy in general.

1. **Ensure that the financial sector makes a fair contribution to public finances.** The underlying assumption is that the financial sector is under-taxed compared with other sectors. However, the proposal fails to take into account that the financial sector bears significant costs of hidden VAT and already contributes greatly to the Member States' budget, notably via bank levies as well as corporate taxes paid by the sector.

2. **Limit undesirable market behaviour and help stabilise markets,** but it will in fact create market disruptions and significantly affect liquidity.

3. **Raising revenues,** but as currently designed will result in massive delocalisation/disappearance of certain activities: thus little revenue is to be expected. With the impact assessment far from being conclusive and accurate, final conclusions cannot be drawn based only on assumptions.

4. **Ensure a proper functioning of the Internal Market**. There are, however, serious concerns over delocalisation of financial transactions towards other international financial centres outside the FTT-zone and outside Europe, hence putting Europe's economic independence at stake.

Therefore, the EBF urges participating MS to drop the current FTT project and to consider more appropriate ways to address issues such as reducing systemic risk and limiting speculation.

KEY IMPACTS

IMPACT ANALYSIS

The negative implications of the proposed FTT are well documented. There is also evidence that recently imposed FTTs in some EU Member States are not achieving their intended objectives. Numerous governments, independent research studies, financial market experts, tax experts, and prominent market commentators have all expressed their concerns over such a tax and have identified the many shortcomings of the proposal. These concerns are based on:

- the negative impact the tax would have on market efficiency and liquidity;
- its hindrance on achieving regulatory objectives;
- the clear lack of global support for such a tax and related potential competitive distortions; and
- its harmful economic impacts.

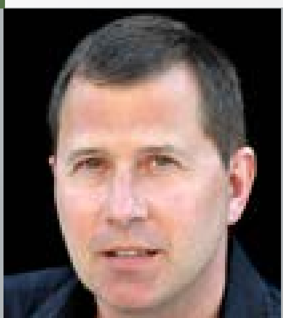
In its impact analysis, the Commission recognises and accepts that the FTT will result in a **massive decrease in market volumes**, notably from market-makers, and a **massive eviction of volumes of derivatives,** which banks use to manage their risks. The taxation of repurchase agreements (repo), a form of short-term secured lending, will have a dramatic impact on the liquidity of financial markets. The Commission appears to welcome such a "structural break", which in their view will force banks to change their business model and encourage them to make longer term investments.

There is an inherent contradiction in the Commission's proposal, which strives to achieve a uniform and consistent method to tax financial transactions across the EU in some cases, and in others cases, creates a **fragmentation between FTT jurisdictions and non-FTT jurisdictions**. This is inconsistent with the EU's goal of a single market and regulatory objectives which have been reinforced to ensure financial stability in the EU.

If the FTT is adopted as proposed by a limited number of jurisdictions, financial institutions around the world will begin to reduce their exposure to financial institutions and businesses within FTT jurisdictions. Despite the fact that the FTT jurisdictions are home to some of the largest financial institutions and businesses in the world, the high mobility of capital will allow financial institutions to, over time, reduce their exposure to affected parties within the FTT jurisdictions, as well as to financial instruments issued in FTT jurisdictions, including government debt securities.

This will lead to a decline in business executed with such institutions. In jurisdictions where business is still executed, capital markets will demand rate or price adjustments for transactions subject to the FTT. The end result would likely be a **reduction in the profitability, size and strength of financial institutions within the FTT jurisdictions, with a detrimental roller-coaster effect on the non-financial economy within these jurisdictions**.

Such a development would not only lower overall tax revenues, but also unfairly marginalise financial institutions in the FTT jurisdictions. In the end, the costs of reduced economic activity in the FTT jurisdictions will far outweigh the perceived benefits of the tax revenues that will be collected under the FTT regime.



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FTT in figures

- The 11 participating Member States represent some 60% of the EU27 banking net income.
- EU11 FTT is expected to raise €34bn with -0.28% hit to GDP.
- The EU estimates the FTT would cause cash volumes to fall by 15% and derivatives by up to 75%.