EU Savings Directive: an investor view

The Eurobond markets can rest easy, says Tim Barker of Deutsche Bank, because the impact of the EU Savings Directive is not going to be as bad as they thought.

On 16 January an article was published on the Association's website that began "All Eurobond and MTN issuers, whether domiciled in the EU or not, will be affected by the EU Savings Directive unless they issue before 1 March 2001. After this date the markets may dry up for a period unless market practitioners can develop ways of protecting issuers and investors from the impact of the Directive in the short time available".

Alarm bells are ringing

This story has led to a number of issuers contacting Deutsche Bank alarmed at the prospect of the Eurobond market being 'closed' or impaired in some way. The EU Savings Directive is not expected to come into force until 2003 at the earliest but, if and when it does, it will be retrospective to 1 March 2001 for new bonds and 1 March 2002 for 'tap' issues.

The initial plans envisaged the imposition of a 'withholding tax' across the EU. However, because of the implications of this plan for the Eurobond market, predominantly based in London, and specifically the costly implications for the UK pensions industry, it was changed.

Instead of 'withholding tax', a system of information exchange between tax authorities was proposed. The good news is that bonds issued before 1 March 2001 are exempted from this Directive and will be 'grandfathered' – that is, assumed to be compliant or beyond the remit of the Directive and therefore not subject to change.

The withholding tax debate in the UK has centred on the fact that certain outstanding bonds contain language in their documentation that means any change to the tax regime that results in the coupons having to be 'grossed-up' would trigger a call option.

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The potential damage to investors and their portfolio's stems from the fact that the call option would enable those bonds affected to be redeemed at par. For many UK investors this would have resulted in a potentially large capital loss as many of the bonds in question were issued some time ago and now trade at levels significantly over par, but 'grandfathering' has neutralised these concerns.

Tim Barker

Withholding tax

Within the framework of the Directive, it will be the responsibility of individuals and paying agents, albeit subject to a broader definition than is usual, to provide the relevant information to the tax authorities. Although the EU has agreed to adopt the UK's proposal of information sharing, instead of imposing a unilateral withholding tax, some EU countries (including Luxembourg, Austria and Belgium) are said to be pressing ahead and levying a withholding tax. Since the Directive only applies to payments made by a paying agent in one EU country to an investor in another EU country, the domicile of the issuer is immaterial.

A cause for concern

We believe that the effect of this Directive should be minimal. First, it will not affect the institutional investor base (particularly given the grandfathering), because they are already required to provide information to their respective tax authorities. Therefore, this affects only individual retail investors, that may be worried about their financial affairs becoming known to their tax authorities. Clearly, because of the clandestine nature of any tax evasion, it is difficult to say how much of an impact this might have on demand for bonds.

Clearly, the authorities across continental Europe must be reasonably concerned to have proposed the Directive in the first place. However, it is hard to imagine the magnitude of the problem being sufficient to have a meaningful impact on the market. ■

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