



The European Association of Corporate Treasurers

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Comments concerning the Proposal for a Council Directive implementing enhanced cooperation in the area of a financial transaction tax

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The European Association of Corporate Treasurers (EACT)

The EACT is a grouping of national associations representing treasury and finance professionals in 17 countries of the European Union. We bring together about 12,000 members representing 6,500 groups/companies located in the EU. We comment to the European authorities, national governments, regulators and standard-setters on issues faced by treasury and finance professionals across Europe.

We seek to encourage the profession of treasury, corporate finance and risk management, promoting the value of treasury skills through best practice and education.

Our contact details are provided on the final page of this document.

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1 – Introductory comment

The EACT broadly supports the stated objectives of the proposal for a Financial Transaction Tax (FTT) – on the one hand, to ensure that the financial sector makes a fair and substantial contribution to covering the costs of the financial crisis and on the other, to create disincentives for certain financial activities that it may be agreed do not bring added value for the overall economy. In general terms we are supportive of reforming the financial sector in order to avoid future financial crises and to ensure that it better serves the interests of the real economy.

However, we strongly believe that the FTT will not deliver on the above-mentioned objectives. It will on the contrary add further difficulties to the struggling European economy. The tax's impact on the real economy has not been properly assessed and recognised during policy formulation. The FTT will cause serious damage to companies, pension funds and individuals as users of financial

services, by directly and indirectly burdening them with additional costs. The FTT will not in the end fall solely on the financial sector and force it to make a fair contribution to the costs of the financial crisis but will do just the opposite. It will fall on companies in the real economy and compound the negative effects of the financial crisis that businesses have already experienced. In the current economic context this outcome is the opposite of what EU policy should be addressing.

2 - Impact of the FTT on the real economy

2.1 – Direct impacts

The FTT will increase costs for corporates in several ways. Although not all corporates will directly incur FTT, all businesses will **suffer from the costs that the financial sector will undoubtedly seek to recover from end-users** – the companies, pension funds and individuals referred to above. To make matters worse, the FTT has an **unprecedented cascading effect** within the financial system; FTT will apply separately to each element of a transaction; and there is no intermediary exemption. In addition to this, FTT will be applied separately to all material modifications of a contract, e.g. derivative contract modifications. The impacts of this accumulation of costs will be felt by corporates on different levels:

- **Increased cost of funding and tightened credit conditions:** issuers of corporate debt will have to offer higher returns to investors due to FTT eroding investors' returns, thereby raising the overall cost of capital. Liquidity in secondary markets is also likely to be reduced, putting further upward pressure on the cost of capital. Corporates are already suffering from a strong decrease in lending from banks and a consequential dependence on funding from other sources such as the capital markets, where this is feasible.

The economic consequence will be a reduction in investment in the economy, which **will result in lower GDP and downward pressure on employment**. Furthermore, this is in contradiction with the European Commission's objectives of fostering and improving the supply of long-term financing of the economy, as described in the Green Paper on long-term financing.

- **Increased cost of hedging:** corporates use derivatives in order to mitigate their business risks; this benefits the economy by introducing greater certainty in planning and forecasting together with more stable prices for customers. The importance of safeguarding hedging has been recognised by the exemptions included in EMIR and CRR (CRD IV) for non-financial counterparties; **the FTT proposal threatens a partial reverse of this policy**. Hedging will be particularly impacted by the FTT as one derivative contract usually necessitates several underlying transactions, all of which will be taxed.

- **Direct liability for certain corporates:** within the FTT proposal the definition of a financial institution is extremely broad, capturing a large number of corporates that typically achieve efficiencies and reduced risk by centralising their treasury operations. **This increases the burden of the tax even further** as this direct payment of FTT will come on top of the costs passed on by the financial system (the cascade effect). In no context, other than that of FTT, would the corporates classified here as financial institutions be regarded as part of the financial sector.
- **Intra-group transactions:** transactions between different parts of the same corporate are central to efficiency and risk reduction, as noted above. As these will also attract FTT **this value-added activity risks becoming uneconomic.**
- **Increased cost in the provision of pensions:** well-documented studies illustrate the extent to which the cost of meeting pension obligations to current and former employees will be materially increased by the FTT; as a result of the **diluted returns earned on investments** corporates will need to make further provision for funding pensions, allocating capital that would otherwise be available for direct investment in the real economy.

2.2. Examples of the expected financial impact of the FTT on corporates

Below are some illustrative examples of the additional costs that the FTT would have on three EU companies' (two of which are in the FTT zone) derivative transactions over a one-year period. These calculations assume that the company will not be classified as a financial institution and take into account the FTT charge on a trade between corporate and bank and the first level of the cascade effect, i.e. assuming that banks' hedging costs will be passed on to the corporate.

It is important to note that these calculations have been made **only on derivative transactions** and therefore the figures below do not include further impacts of the FTT on intragroup trades, buy/sell of UCITS, pension funds' transactions etc. which will further increase the costs.

	Cross-currency swaps	FX forwards and swaps	Commodity swaps	Interest Rate swaps	Total (millions of euros)
Company 1 (non-FTT zone)	0.1	0.88	0.035	0.17	1.19
Company 2 (FTT zone)	-	16.55	-	1.58	18.13
Company 3 (FTT zone)	-	27.30	-	0.82	28.12

As a further illustration an EU company in the services sector - which would fall under the definition of a financial institution for FTT purposes - has calculated the likely direct costs of the FTT to be in excess of 40 million euros per year. This figure does not take into account the cascade effect which would significantly increase the real costs to be borne by the company.

2.3 Longer term consequences

Besides the above direct effects, the FTT will have other longer term and structural negative impacts:

- Corporates as well as other entities (FTT zone, non-FTT zone Member States and non-EU) may avoid entering into any transactional contact with the FTT zone; this structural shift will have potentially devastating consequences for FTT zone businesses
- Diversion of capital investment and even corporate domicile away from the FTT zone and perhaps even away from the EU as a whole
- Serious impact on the competitiveness of European businesses by awarding a competitive advantage to non-EU businesses
- The derivatives used to hedge funding in international markets will be less cost effective, forcing companies to become more dependent on local domestic funding sources that may be unable to provide the amounts and flexibility required

3 – Proposed amendments to the Proposal

For the reasons outlined above, we strongly encourage the Council to give proper attention to the consequences of the FTT for the real economy. The real economy should be protected by **excluding non-financial institutions from the scope** of the Directive and by **introducing exemptions for intragroup and hedging transactions as well as corporate pension funds**. However even an amendment of this type will be of limited value because of the cumulative effect of the tax throughout the chain of transactions within the financial sector; as already noted the cost of this cascade effect will inevitably be reflected in the pricing of end user (non-financial counterparty) transactions.

More fundamentally, we believe that **alternatives to the FTT**, for instance direct taxation of the financial sector through a FAT (Financial Activities Tax) or other form of financial sector contribution should be urgently considered by the Council. **Such alternative approaches to taxation have the advantage of actually satisfying the legitimate objective of seeking a material contribution from the financial sector but without further penalising the real economy.**

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