gfma afme/ asifma sifma

16 July 2013

Dear G20 Central Bank Governors,

Re: Opposition to the EU's Proposed FTT

On behalf of the Global Financial Markets Association ("GFMA")[1], we write to express our strong opposition to the EU's proposed financial transaction tax ("FTT"). As currently designed, the proposed FTT will harm economic growth at a time of significant economic uncertainty by *inter alia* increasing government and corporate borrowing costs, and will undermine the effectiveness of monetary transmission channels.

In addition, the FTT would have unprecedented extraterritorial impacts, contrary to G20 principles and commitments. We understand a number of central banks have already raised their concerns publicly with the proposed tax. We respectfully ask you, the G20 central banks, to continue monitoring the proposal, and where appropriate, express your opposition.

Despite repeated calls by the G20 to avoid measures exhibiting extraterritorial effects, the proposed FTT would apply to transactions well beyond the eleven EU member states (EU11) that have agreed to adopt it through the EU enhanced cooperation procedure. In particular, it would apply to all transactions where: (i) either the buyer or seller is resident in an EU11 country; (ii) the security was issued in an EU11 country; or (iii) an EU11 financial institution, or any of its foreign branches, is involved in the transaction. For example, the FTT would apply to the sale of French government bonds by a Japanese bank to a Canadian bank through a US broker-dealer.

The FTT will increase the cost of equity and debt financing for both governments and corporates, increase the cost of hedging transactions undertaken in the real economy in order to manage risk, and create a further headwind to the European and global economic recovery. It would apply to virtually all transactions, including repurchase transactions and stock loans, thereby multiplying the adverse effects on the global economy. It does not include an exemption for market-making or inter-affiliate transactions, and covers not only equities, but also debt securities (such as government bonds) and derivatives.

Numerous studies have quantified the FTT's harmful effects. The FTT's impact on the repo market has proven of particular interest to central banks. The current design will distort the repo market in a number of ways, and most importantly it will potentially make short term repo transactions economically unviable. The International Capital Market Association (ICMA), for example, estimates the proposed FTT would cause the short-term European repo market to contract by at least 66%, causing capital flight harming bank funding, and thus lending to the real economy[2], within the EU11 countries. This would potentially also impact central banks' monetary policy.

[1] The Global Financial Markets Association brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. For more information on GFMA, please visit http://gfma.org/about/.

[2] "Collateral damage: the impact of the Financial Transaction Tax on the European repo market and its consequences for the financial markets and the real economy," *International Capital Market Association,* April 2013

ICMA's report notes "that liquid collateral is essential to the flow of credit in the modern financial system and repo is the primary vehicle for collateralised credit. If the movement of collateral through the market is impeded, the flow of central bank credit would also be adversely affected."

The FTT will also directly increase the cost of collateral transfers (not limited to transfers for the purpose of collateralizing OTC non cleared, OTC cleared, on exchange, repo and stock lending). This will undercut the regulatory drive to collateralize both cleared and bilateral transactions under EMIR rules and ongoing BCBS IOSCO work. Collateral transfers facilitate essential counterparty risk mitigation in the market, which is – for valid reasons – recognized as exempt from tax under other European laws (e.g., UK stamp duty, French, and Italian FTT). Market participants may reduce, or at worst stop, using EU11 Government bonds, equities and corporate bonds as collateral.

The impact of the tax on secondary trading in the government bond market would raise the cost of government funding. A recent study prepared by Oxera for the Association for Financial Markets in Europe concludes that the tax could increase EU government debt interest payments by €2 billion per annum, and that EU member states with relatively few resident financial institutions trading government debt, but a relatively large amount of debt, would be relatively worse affected. Moreover, London Economics calculated that the increased cost of capital for corporates would lead to a 3.6% drop in business investment and a 1% reduction in GDP in the 11 participating countries.

The GFMA's FX Division recently published analysis[3] of both corporate and fund manager 2012 trading FX activity impacted by the proposed FTT. This showed that should the tax be applied to trading in these FX products (noting spot FX is already excluded), corporates would see the cost of their FX transactions rise by 300-700%, with the potential to either discourage international trade or at least disincentivise beneficial hedging.

Moreover, the European Commission itself has predicted the proposed FTT could result in a 75% plunge in derivatives trading volumes. This would have important implications for those corporations and market participants that use these products as an essential risk management tool, such as firms that import and export goods, or the management of pension plans. The tax would result in higher costs, and limit the availability of these products, hampering the ability of corporations, pension funds, and other entities to hedge their interest rate, currency, credit and counterparty risks.

Finally, the impact of this tax will also be felt by savers and retirees. The European Fund and Asset Management Association estimates that a person investing €100 per month during 40 years in a UCITS would see the value of their savings reduced by about 15% of the person's total contributions. Further, EFAMA estimates that the cost of the FTT would reduce the annual investment performance of MMFs by at least 1%.

[3] GFXD Briefing Note: GFXD Analyses Impact of Proposed EU Financial Transaction Tax on Foreign Exchange Markets, http://www.gfma.org/correspondence/item.aspx?id=495

Global markets remain fragile, with many economies experiencing historic levels of unemployment and unusually slow recoveries. G20 central bank efforts to stabilize and support the global economy have helped bolster the investor and consumer confidence that is essential to support economic growth and job creation. The introduction of the proposed EU11 FTT works counter to these very goals, and undercuts the European Commission's goal to foster the supply of long-term financing, diversify the system of financial intermediation, and spur economic growth, as expressed in its Green Paper on the long-term financing of the European economy.

Sincerely,

Simon Lewis
CEO
GFMA