European Federation
for Retirement Provision

07 February 2012

EFRP Position

On the

Proposal for a Council Directive on common system of Financial Transaction Tax and amending Directive 2008/7/EC, COM (2011) 594 final

INTRODUCTORY STATEMENT

The European Parliament and the Council of the European Union are currently in the process of discussing a Proposal from the European Commission for a Directive on a common system of financial transaction tax (FTT). The Proposal sets a common tax on all transactions, carried out by financial institutions based in the European Union. So far, only the Czech Republic, Denmark, Ireland, Malta, Sweden and the United Kingdom have expressed their opposition to the Proposal.

The European Federation for Retirement Provision (EFRP) understands some of the underlying reasons of the Proposal, namely, obtaining a fair economic contribution from the financial sector.

However, the EFRP expresses its deep concern about the ratio and concrete structure of this Proposal, which would severely impact pension beneficiaries. If the Proposal was approved in its current form, Institutions for Occupational Retirement Provision[1] would be deeply affected by this tax. The consequent increase of costs would be born by beneficiaries, in terms of reduced benefits: current and future pensioners would be requested to pay even more the costs of a financial crisis, which has already affected their income. Pension funds and IORPs would be taxed to recover costs of a financial crisis, which they are not responsible for. On the contrary, pension funds and IORPs have been suffering the effects of the crisis and they are contributing to alleviate it, by providing long-term investments and market liquidity.

Moreover, it seems ironic that many Member States strongly encourage their citizens to provide for their retirement, not least with tax incentives, in order to alleviate the strain on state pension systems, and yet entertain the idea of a tax that will counteract these efforts.

[1] And other forms of occupational pension provision

The proposed FTT would make transactions more expensive. Hence, this tax would affect IORPs in different respects:

1. Net returns would be lower;
2. The investment strategy would be impacted : there would be a disincentive for pension funds, IORPs and institutions managing assets on their behalf to carry out transactions; this may lead to a less efficient investment strategy.
3. There would be less liquidity circulating on the market, in a moment where liquidity is desperately needed;
4. It would be more expensive for pension funds and IORPs to hedge against risks. Pension funds and IORPs use derivatives for risk-mitigating purposes. The FTT will lead to a disincentive to use derivatives, which may imply higher risk for pension funds, IORPs and their beneficiaries.

Higher costs, lower returns and less efficient investment strategy for pension funds, IORPs and companies managing assets on their behalf will determine lower benefits for pensioners.

In sum, the FTT would affect:

1. Pensioners. They would receive lower benefits, in a moment where occupational pensions can represent an important income, supplementary to the State-provided pensions, which are constantly shrinking because of budgetary restrictions and ageing;
2. Pension funds, IORPs and companies managing assets on their behalf. These would not be able to look after the best interests of their members and beneficiaries, in particular because the administrative requirements to establish systems of tax collection, would be too burdensome for small and medium pension providers;
3. The economic and financial system in the EU. An FTT reduces economic growth in the long run[2]. Furthermore, the FTT will probably reduce liquidity.

[2] The Commission itself foresees a negative impact of FTT on GDP of 0.53 to 1.76%. European Commission – Executive summary of the impact assessment – Proposal for a Council Directive on a common system of financial transaction tax and amending Directive 2008/7/EC

The EFRP invites the European Parliament and the Council of the European Union to dismiss the Proposal. However should the tax be introduced, then pension funds, IORPs and financial institutions managing assets on their behalf should be exempted from its application.

EFRP ASSESSMENT OF THE FINANCIAL TRANSACTION TAX

In the Impact Assessment accompanying the Proposal for a Council Directive on a common system of financial transaction tax[3], the European Commission identifies some main reasons for imposing this tax. These reasons can be challenged individually.

1. *Costs of the crisis*

   The Commission reports a common claim in public debates that the financial sector should bear its fair share of the costs of the financial crisis. In particular, the financial sector received public funding from Member States in 2009. Such support represents a significant burden on public budgets. Therefore, the financial sector is asked to pay back the contribution it received.

   The EFRP is openly in favour of a fair contribution from the financial sector to the stability of public finances and to the economy in general. However, pension funds and IORPs should not be brought under the scope of the FTT on this basis: one should not forget some fundamental differences between pension funds-IORPs and other financial institutions:

   - Pension funds and IORPs generally fulfil a social function: they are independent and not-for-profit, controlled by employee and employers organisations, with the sole purpose of providing an adequate workplace pension to beneficiaries;
   - Pension funds and IORPs generally do not speculate: they are financial markets participants, but with the special characteristic that they are creditworthy, non-commercial investors on financial markets with a focus on the long-term. Although they have a small portfolio turnover, pension funds and IORPs would suffer from a severe impact of this tax, due to high number of transactions carried out in the long-term.

[3] SEC(2011) 1103 final

Moreover, we would like to recall that the Commission itself acknowledged that pension funds and IORPs did not experience the same problems as other financial institution during the crisis[4]:

- Pension funds and IORPs did not require any support in terms of funding from public finances. On the contrary, pension funds and IORPs paid the costs of the crisis, in terms of lower investment returns. Furthermore, they contributed to mitigate the crisis, by keeping their long-term liabilities in the financial markets.

As a consequence, we do not see any reason to impose FTT on pension funds, IORPs and companies managing assets on their behalf.

2. *VAT exemption of financial services*

The Commission claims that the exemption from the payment of VAT results in a preferential treatment of the financial sector compared with other sectors of the economy as well as in distortions of prices. Pension funds, IORPs and special investment funds acting on their behalf are generally exempted from VAT for the sake of fiscal neutrality and in order to avoid a distortion of competition. This tax exemption aims to keep the price of retirement benefits low. Finally, the purpose of the exemption is to make sure that small investors (small and medium sized pension or investment funds with not enough resources to invest in a wide spread of assets and benefit from professional management) are not prevented or not treated unfavourably compared to larger ones.

Even assuming that the VAT exemption leads to a tax advantage (which shall still be demonstrated by the Commission), the EFRP does not see any reason to counterbalance the VAT exemption with a tax that would have:

- Cascade effects[5] on pension funds and IORPs: as pension funds and IORPs usually refer to asset managers to operate in the financial markets and as a single exchange of a security requires multiple payments of the tax, there will be a multiple increase of the actual rate of the tax. When

[4] EC, Economic crisis and pensions, MEMO, 09/99
[5] IMF, A Fair and Substantial Contribution by the Financial Sector, G20 Report, July 2010

benefiting from the expertise of an asset management fund, pension funds or IORPs would be liable to tax at least in the following instances:

1. When the asset management fund arranges a transaction on behalf of the pension fund or the IORP (i.e. when the fund buys/sells a holding);
2. When the pension fund or the IORP buys or sells the assets in question (i.e. when the IORP buys/sells units in the fund);

- Indiscriminate effects on transactions carried out by pension funds and IORPs. Although being prudent and part of a long-term strategy, financial transactions by pension funds and IORPs will be taxed in the same way as risky transactions carried out by other financial operators which are pursuing profit only.

  Such approach is contradictory to one of the purposes of the Proposal, namely reducing risky trading activities. The International Monetary Fund has highlighted that by making no distinction between undesirable and desirable trading activities, the FTT would reduce liquidity, this could increase volatility[6]. This increase in volatility may in turn create more rather than fewer opportunities for speculation.
- Dissuasive effects for non EU investors: when making the choice whether to enter into a transaction with an EU-based pension fund or IORP (or any financial institution), investors from outside the EU would take into account the supplementary cost represented by the tax burden. Therefore, this tax would have a distortive effect for the financial market in the EU and lead to a competitive disadvantage *vis-à-vis* operators located in other areas of the world.

In conclusion, we don't see any reason to counterbalance the VAT exemption with a different tax that would have multiple disruptive effects on the economic and financial environment in the EU. Moreover, we question the effectiveness of the FTT in addressing the issues it is supposed to.

3. Market failure and systemic risks in the financial sector

[6] "“***An FTT would reduce market price volatility.***” *It is now generally recognized that this is not always true in either theory (thinning of markets, for instance, can increase volatility) or practice (the empirical finding generally being that transactions taxes either do not affect price volatility or increase it)*", IMF, G20 Report, p. 20

As demonstrated above and confirmed by the IMF[7], this tax would not target any of the key attributes that increase systemic risk and would not address major market failures which led to the financial crisis. Rather, it will reduce market liquidity and this could increase market volatility. Less liquid markets could increase speculation, which is contrary to the aim of the FTT.

4. *Internal Market Aspects*

By this tax, the Commission intends to address risks of relocation and distortion of competition in the Single Market, due to unilateral imposition of various taxes and levies on the financial sector by Member States in the aftermath of the crisis.

The EFRP, as many other EU associations, sees a clear risk of relocation of financial operators, which would easily avoid a tax applied only at EU level rather than on a global scale. As there is clearly no agreement in the G-20 to introduce such a tax on the global level, the risk of relocation of financial operations outside the area covered by the FTT is high. The Swedish experience with a FTT-like tax clearly shows that the introduction of a transaction tax could lead to a movement of trading activities to other regions. *Ironically, especially the high-frequency traders could easily move their activities to other regions, while this is not possible for more stable institutions like pension funds and IORPs.* The risk of relocation would be even higher in case some Member States opted-out of the initiative, as it seems very likely at the moment. In this perspective, the application of a FTT only in the Eurozone would disrupt the internal consistency of the Single Market.

Moreover, there is a clear risk of overlap of this Proposal with other legislative measures adopted by the EU in the financial sector, such as the European Market Infrastructure Regulation. In case of OTC derivative contracts, for example, multiple transactions included in one contract will be subject to multiple taxation. This would discourage the same transactions that the EMIR is supposed to encourage, in view of securing them.

[7] Ibidem

Finally, the IMF highlighted that a FTT could be easily avoided through financial engineering: this would bring further complexity to the financial market in the EU and to its coherence: "*Experience shows that—even leaving aside the question of whether transactions could, or would, escape the tax if imposed only by a few countries—financial transactions seem to be particularly vulnerable to avoidance by engineering*"[8].

Conclusions

The EFRP warns against the disproportionate impact of the Financial Transaction Tax on pension beneficiaries. They will be further affected by the costs of a crisis, which they are already paying for. Moreover, we recall the specificity of pension funds and IORPs and differences between pension funds-IORPs and financial institutions in terms of social function, market behaviour and their role during the crisis.

We consider that the introduction of the FTT would have unexpected disruptive effects on the activities of pension funds and IORPs as well as on their beneficiaries, on the stability of financial market in the EU and on the competitiveness of EU-based financial operators.

We highlight that the proposed FTT would not be consistent with other EU legislation and would increase the risk of tax avoidance in the EU.

The EFRP invites the European Parliament and the Council of the European Union to dismiss the Proposal, on the basis of the above-mentioned reasons. In any case, we invite the EU institutions to take into due account the consequences of the FTT in terms of decrease of benefits for pensioners and not to impose a further financial burden on EU citizens who are already paying a high cost for the crisis.

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[8] Ibidem, p. 21

ABOUT THE EFRP

The **European Federation for Retirement Provision (EFRP)** represents national associations of pension funds and similar institutions for supplementary/occupational pension provision. Its membership consists of institutions for work-related (2nd pillar) retirement. Some of them are also operating purely individual pension schemes (3rd pillar).

The EFRP has **22 members associations** in most EU-15 Member States and other European countries that have a significant – in size and relevance – workplace pension system[9].

In October 2006 the EFRP established the **Central & Eastern European Countries Forum (CEEC Forum)** to discuss issues common to pension systems in that region.

83 million EU citizens are covered for their workplace pension plan by EFRP members. Through its Member Associations the EFRP represents approximately € **3.5 trillion of assets (2009) managed** for future occupational pension payments.

EFRP Members are large institutional investors representing the **buy-side** on the financial markets. They are specialised institutions solely dedicated to the accumulation and decumulation of assets to provide a supplement to the State pension to avoid old-age poverty.

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[9] EU Member States: Austria, Belgium, Finland, France, Germany, Hungary, Ireland, Italy, Luxembourg, Netherlands, Portugal, Romania, Spain, Sweden, UK. Non-EU Member States: Croatia, Guernsey, Iceland, Norway, Switzerland.