

Insurance Europe comments on the Commission's proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax.

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I. Introduction

Insurance Europe opposes the European Commission's draft proposal (**Proposal**) implementing enhanced cooperation in the area of financial transaction tax (**FTT**).

Insurance Europe is concerned that the FTT as outlined in the Proposal would have a serious negative impact on the real economy. This would be particularly damaging at a time when Europe continues to struggle to sustain an economic recovery. The Commission's own impact assessment study calculates that, under certain scenarios, the FTT would have a negative impact of 0.28% on the EU GDP¹. In Insurance Europe's view, the negative impact on Europe's economy would primarily be the result of a significant increase in the cost of funding of companies, as a result of significantly less liquid financial markets and increased costs on financial intermediaries. This increase in the cost of funding will in turn, affect the future levels of investment by Europe's companies in the European economy.

Moreover, Insurance Europe believes that the introduction of an FTT in a limited number of EU countries would disrupt rather than strengthen the EU single market, as it would increase the differences between the FTT markets and the non-FTT markets. The entry into force of the FTT would lead to a competitive disadvantage for companies from jurisdictions subject to the FTT. On the other hand, the FTT proposal would have significant extra-territorial effects, as financial institutions established outside the FTT-zone would be liable to pay the FTT on all their transactions with financial institutions established in a participating state. This would undoubtedly discourage them from conducting transactions with counterparts in the FTT-zone. Insurance

¹ European Commission, 2013, Impact Assessment accompanying the document Proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax, Page 45.

Europe is very concerned of the consequences that this strong divide between the two categories of countries may have on the functioning of the EU Single Market.

In addition, Insurance Europe is concerned that, even if the conclusion of insurance contracts is excluded from the scope, the FTT proposal will have a significant impact on insurance companies and their customers, notably through a higher cost of protection and lower returns on long term products. Here, it is important to keep in mind that investing in financial instruments is a key feature of insurance companies, which receive the premiums up-front from policyholders and invest them in financial assets. The duration of the investment is normally determined by the duration of the liability, as insurers typically seek to match the nature and duration of their liabilities and assets. By taxing all types of financial transactions, irrespective of whether these are conducted for a speculative or investment purpose, the proposal will significantly increase the cost of policyholder protection (as the price of a policy benefits from the investment return) and will decrease the return offered on pension products. We are very concerned that, ultimately, the substantial cost of the EU FTT will be paid by the consumers, as was outlined by the International Monetary Fund in its June 2010 report "*A fair and substantial contribution by the financial sector*".

For these main reasons, Insurance Europe opposes the introduction of the FTT, as designed by the Commission.

If, despite the above concerns, participating member states decide to move ahead with the FTT, Insurance Europe believes that the rationale for the inclusion of insurers should be reconsidered or at the least, the proposal should be profoundly amended to ensure that the anticipated rise in costs of long term products is minimised. The following points should be considered as a matter of priority:

- ➔ Retirement products should not be included in the scope of the FTT.
- ➔ Transactions with bonds on the secondary market should be excluded from the FTT regime.
- ➔ Economically unified transactions should be taxed only once.
- ➔ Transactions within groups should be outside the scope of the FTT.
- ➔ Imposing a tax on derivatives should be reconsidered.
- ➔ Repurchase agreements and securities lending trades should fall outside the scope of the FTT.
- ➔ No joint liability for the payment of the FTT should be envisaged.
- ➔ Implementation of the FTT should be harmonised. In particular, a uniform tax rate of 0.01% should be applied.
- ➔ The introduction of the FTT should be delayed to ensure it can be collected accurately and efficiently. Insurers should be able to pay the due taxes via brokers and intermediaries.

Insurance Europe's more detailed comments on these points are set out below.

² IMF report on "A fair and substantial contribution by the financial sector", [June 2010](#).

II. Impact on long-term life insurance savings products, including retirement products.

Retirement products and long-term savings products offered by life insurers should be excluded from the FTT regime.

While formal legal liability for payment of the FTT would generally lie with financial institutions, the resulting tax burden would be rolled over to end consumers.

This is in line with one of the conclusions of the IMF's June 2010 G20 report on the FTT, which states that:

"Its real burden may fall largely on final consumers rather than, as often seems to be supposed, earnings in the financial sector. No doubt some would be borne by owners and managers of financial institutions. But a large part of the burden may well be passed on the users of financial services (both businesses and individuals) in the form of reduced returns to saving, higher costs of borrowing and/or increases in the final commodity prices³".

In the insurance sector, the costs of the FTT will push up insurers' expenses and consequently premiums to end-customers. Such end-consumers include policyholders holding contracts designed to provide financial protection for old age and protection against an unforeseen event. The FTT is specifically designed not to apply to transactions with individuals. Extending the FTT to pension products, including those provided by life assurers, is in direct opposition to this policy intention. Logically, the tax system should not discourage long-term savings, especially those associated with risk coverage.

Such a move would be particularly inappropriate at a time where efforts are being made to encourage financial protection for old age. Imposing an additional tax burden on retirement and other long-term insurance savings products seems to be inconsistent with the objective as put forward by the Commission in the White Paper on Pensions⁴ and efforts of Member States aiming to increase role of complementary retirement savings plans in pension system as a response to demographic changes.

In the White Paper on pensions, the EC stated that complementary retirement savings have to play a greater role in securing the future adequacy of pensions. Therefore, member states need to find ways of improving the cost-effectiveness, safety and equitable access to supplementary pension schemes. In this respect, member states are encouraged to increase the share of funded pension schemes, notably second-pillar (funded occupational pension schemes) and third-pillar (individual voluntary contracts normally between individuals and insurance companies and incentivised by governments usually via tax breaks) pension products.

Life insurance companies account for almost half of the second pillar provision of pensions in the EU (a market share of 47%) and virtually the entire third pillar (a market share of 90%)⁵. The retirement products provided by insurance companies are thus indispensable for meeting the challenges facing member states in their efforts to address the problems presented by ageing populations.

Therefore, in order to ensure that Europe's pensioners and investors are not adversely affected, it is essential that any arrangements specifically addressed for pension funds under the FTT regime, properly reflect and are applied to the entire market for retirement products, regardless of their legal form.

This would require a review of the scope of any exemption from the FTT beyond the definition of an Institution for Occupational Retirement Provisions (IORP). In Insurance Europe's view, this should be based on the principle of "substance over form", whereby all financial institutions that provide pension products should be regulated not on the basis of the legal vehicle through which products are sold, but rather according to the benefits those products provide to members and beneficiaries. As a result, members' and beneficiaries'

³ Idem

⁴ EC White Paper on "[an Agenda for Adequate, Safe and Sustainable Pensions](#)"

⁵ Insurance Europe Statistics No 28 (2008): The role of insurance in the provision of pension revenue.

benefits should neither depend on the legal form of the institution they are affiliated to, nor on the supervisory regime.

Since it is not possible to provide a comprehensive definition of a “pension product” at EU level, as products differ from country to country, Insurance Europe recommends defining pension products for the purposes of the FTT Directive at national level.

III. Impact on bonds

Transactions with bonds on the secondary market should be excluded from the FTT regime.

European insurers are significant investors in both corporate and government bonds, with around €5trn invested in these assets⁶. The main rationale behind insurers’ choice for bonds is the need to be invested in assets that can match insurers’ liabilities’ profile, in terms of maturity, liquidity and return (where insurers offer products with guarantees). Insurance companies acquire bonds via both the primary and the secondary markets and the availability of these assets is vital for good insurance asset/liability management.

The Proposal does exempt primary market transactions from the FTT. However, the primary market is intrinsically linked to the secondary market, which unfortunately would be subject to the tax. At the same time, the existence of a secondary market is the determinant of the liquidity of a bond issuance, as well as the main prerequisite for the availability of assets. At different points in time, insurers will have different needs in terms of maturity profiles or underlying exposures and the primary market alone cannot ensure the availability of assets with different characteristics. Therefore, the secondary market, with a wide range of investable assets, is vital for insurance companies.

However, the new FTT tax could distort the attractiveness of bonds. The closer to maturity a bond will be, the higher the disincentive to trade it, as any transaction will generate a tax liability. In particular, this affects the attractiveness of short-term bonds, whose trading on the secondary market will become more costly. As the FTT makes the holding of short-maturity government debt less attractive, longer term bonds may need to be issued instead, which ordinarily are higher risk and hence require higher interest payments. The FTT charge of a minimum 20bps, without taking into consideration cascading effect, on each transaction is the same whether a bond, including a government bond, has one day or 50 years to maturity.

Furthermore, imposing the FTT on the secondary bond market affects the attractiveness of medium - and long-term bonds, as investors will know that at some point during the life of the bond it will no longer be “saleable”, in which case the investor would implicitly require an illiquidity premium as a sort of compensation for having to hold the bond from that point until its maturity. In all cases, issuers of debt will need to compensate for the expected FTT charges on the secondary market by offering significantly higher returns to investors.

Therefore, the cost of finance for both corporates and governments via the issuance of bonds could become significantly more expensive, increasing the cost of investment for firms) and the cost of debt and spending for governments.

Finally, it is worth mentioning that imposing the FTT on transactions with bonds on the secondary market is contrary to the EC objective of stabilising markets. An insurer that wishes to increase its holdings of government bonds — long recognised by regulator and rating agencies as low-risk assets — by selling down its holdings of equities, properties and other higher risk assets, will incur a double FTT charge, both on sale of the riskier assets, and purchase of the safer assets. This should be compared to existing transaction taxes, such as UK Stamp Duty or the French FTT, which would only tax the acquisition of a riskier asset. The structure of those transaction taxes is better suited to meeting this particular objective.

For all these reasons, the FTT as currently envisaged on life assurance products could diminish policyholders’ benefits. If compounded by the low interest rate environment and the low returns available on government and corporate bonds in which insurers invest substantially due to their low risk profile, this will translate into

⁶ Funding the future: Insurers role as institutional investors”, 2013

future stresses on social security provisions as savers retire. Insurance Europe therefore believes that bond transactions on the secondary market should be excluded from the FTT regime.

IV. Comments on technical provisions

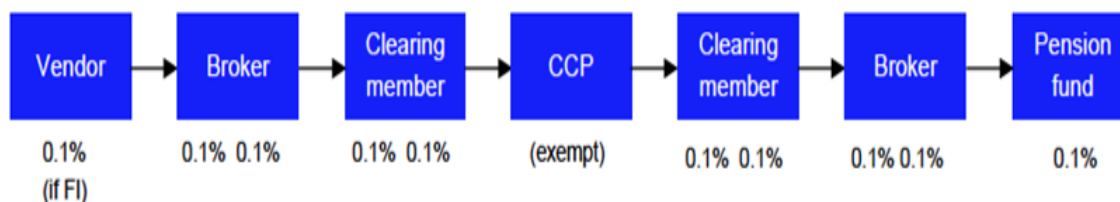
1. Cascading effects

The Proposal needs to avoid multiple taxation of a single transaction.

In general, taxes tend to be net. VAT is a net tax targeting the final consumer, with people earlier in the supply chain being able to reclaim input tax. Corporate taxation is typically on net profits. More pertinently, existing taxes on financial transactions (e.g. those in France, Italy and the UK) are also typically net and have market-making and intermediary exemptions.

In contrast, the FTT is imposed on every single transaction which leads to a “cascading effect” where a single transaction generates multiple instances of the tax. This cascading effect makes the effective rate of the FTT on securities much higher than the headline rate of 0.1%.

The reason is that the chain of trading and clearing that lies behind most securities transactions usually involves various stages of trading and settling transactions. A purchase of securities on a stock exchange, for example, ordinarily involves sale and purchase by a number of parties, including brokers, clearing members and the central counterparty, all being parts of the clearing system. For example, a regular transaction regarding sale of equity involves the following transactions: from vendor to vendor’s broker, to clearing member, to central counterparty, to clearing member, to buyer’s broker and, eventually, to buyer. This would lead to a range of FTT obligations when both the seller and buyer are financial institutions. Moreover, this scenario ignores issues such as repo costs, intra-bank transfers, collateral costs and so on.



The UK House of Lords Select Committee in its report on the FTT⁷ implied that in a typical trade the FTT could amount to 1%. In our understanding a step between a broker and a clearing member could be disregarded as brokers can be clearing members. However, from a competition point of view, an investor should not be disincentivised from choosing different executing and clearing brokers. In any case, a regular purchase of equity is likely to attract at least a 0.6% tax.

It is worth noting that, in some cases, the use of intermediaries is imposed by legislation. The recently introduced European Market Infrastructure Regulation (EMIR), which regulates the clearing of over-the-counter (OTC) derivative instruments, introduces mandatory clearing through authorised central counterparties. This would introduce another 0.1% charge (one leg of a trade).

Despite the important diversification and yield enhancement benefits of non-financial corporate bonds in a portfolio context, the new FTT rules seem to discourage institutional investors from investing in these assets. The new FTT rules could create a system in which non-financial corporates would be artificially prevented from issuing corporate debt and would be forced to gather capital via equity or banking loans.

⁷ <http://www.publications.parliament.uk/pa/ld201012/ldselect/ldcom/287/287.pdf>

Therefore, the "cascading effect" of the FTT would materially affect not just those subject to FTT, but also those exempt. While transactions directly involving exempt entities can be identified, the transactions in the chain prior to them might not be identifiable, the assets may be acquired from a fungible pool, and the original seller may not be able to identify that the end purchaser, after sales to a broker, is exempt.

The EC, in its impact assessment on the FTT, states that the cascading effect can be substantially reduced by replacing the current model of brokering based on propriety trading, where the broker acts as a principal, with an intermediation trading, where it acts as an agent. Based on our analysis, in many cases it is not possible for the broker to act as the agent.

In particular, the bond market is not suited to agency trading because of the illiquid and diverse nature of bonds. Such products have different forms in terms of maturities, sizes or interest rates, and they are traded much less frequently than other securities.

Because of this characteristic of the bond market, brokers play a crucial role in matching orders from investors as well as providing liquidity to the market. In this role, when the broker receives an order from an investor, he needs to find a counterparty willing to buy or sell a bond with a specific interest rate, liquidity or maturity profile. In order to do so, the broker usually acts through its own network of dealers/investment firms. And, if he is unable to find an appropriate counterparty, he may buy the bond from the investor and keep it in its inventory in order to find a buyer in the future. If the broker could not buy a bond and take a risk, many bonds would not have a market, as it is often difficult to match within a given time the unique features of a bond with investor's needs. As a result, the broker provides required liquidity to the bond market. The broker would not be able to provide such a function if he acts as an agent.

In view of this, Insurance Europe believes it would be best to eliminate this impact by exempting long-term savings products, a move that would be consistent with existing transaction taxes.

2. Transactions within groups.

Intra-group transactions should be excluded from the scope of the FTT.

An FTT on intra-group transactions would seriously hamper the business activities of insurers. Insurers and reinsurers commonly need to balance their risk positions and those movements are sometimes a substantial size within a financial group.

In particular, an FTT on intra-group transactions will have a negative impact in the undertaking's risk management. While the Solvency II Directive promotes an economic risk-based approach which provides incentives for insurance and reinsurance undertakings to properly measure and manage their risks, the introduction of a tax on the intra-group transactions will hamper the undertaking's risk management activities.

Furthermore, it is worth mentioning that intra-group transactions are used by undertakings to facilitate the synergies within the different parts of a group and thereby lead to healthy cost efficiencies and profit maximisation, improvements to risk management, and more effective control of capital and funding. Taxation of some intra-group transactions may incentive undertakings to replace those by new arrangements that may be eventually leading to less appropriate from a risk management perspective solutions.

Finally, applying the FTT to reinsurance entities would seriously hamper the business needs of insurers. Insurers use reinsurance to balance their risk positions, especially to protect against natural and man-made catastrophes, which, without reinsurance protection, could threaten the viability of the insurer. The FTT deters such protection, again increasing rather than decreasing risk in the European economy. Reinsurance premiums may also be paid in the form of financial instruments, often because those assets hedge the underlying insurance risk. To apply an FTT to such transfers would impede commercial risk diversification and protection.

3. Taxation of derivatives

Derivative instruments are used in insurance to match liabilities and assets. In order to maintain a sustainable derivatives market, the taxation of derivatives should be reconsidered. In particular, by taxing the notional value of derivative contracts, the FTT would have a considerable impact on insurers' ability to ensure efficient

asset management and control of risk, and would effectively eradicate the European derivatives market over time.

Insurance companies' primary role is to provide protection and to manage policyholders' savings. This involves long-term commitments to policyholders. The liability profile is one of the main drivers of insurers' investment behaviour and asset allocation. Insurers therefore typically buy (long-term) assets aiming to cover (long-term) liabilities. Ideally, a natural mapping between the profile of insurers' liabilities and the profile of their assets should be done via assets with the appropriate risk, return, maturity and illiquidity characteristics. However, it is often the case that appropriate assets to cover liability exposures are not available and insurers therefore need to replicate these exposures via derivatives. For example, for the purpose of cash-flow matching in asset/liability management, an insurer can either buy a coupon bond or enter into a swap contract. A range of studies and surveys have shown that to a very large extent (close to 90% of cases) insurers buy derivatives for hedging purposes. Not only does the FTT threaten the liquidity of the derivatives market, but it also does not sufficiently incentivise, and in fact unnecessarily penalises, good risk management practices.

This is recognised in Article 23 of the Directive 2002/83/EC concerning life assurance which states that "derivative instruments such as options, future and swaps in connection with assets covering technical provisions may be used in so far as they contribute to a reduction of investment risk or facilitate efficient portfolio management"⁸. Similarly, Article 132.4 of Solvency 2 states that "the use of derivative instruments shall be possible insofar as they contribute to a reduction of risks or facilitate efficient portfolio management."

Furthermore, over the past three years a number of safeguards have been introduced into EU legislation, both for market participants who trade in the markets and for trading venues. In particular, EMIR was adopted, aiming to reduce the negative impact of the OTC derivatives market on financial stability. EMIR provides sufficient measures to improve the transparency of the derivatives market, to discourage short-termism and speculation and to provide market resilience and safety. The stated objectives of EMIR are: (i) increasing derivatives standardisation; (ii) using trade repositories; (iii) strengthening the use of central counterparty clearing houses (CCPs); and (iv) increasing the use of organised trading venues.

4. Repo and stock lending trades.

Repo and stock lending trades should fall outside the scope of FTT.

Repo markets play an important role in the liquidity management of institutional investors, such as insurers. The main driver of insurers' investment strategies is the profile of their liabilities. Thus, where liabilities are long-term and illiquid, it makes sense for insurers to match them with long-term, illiquid assets, leading to a rather limited exposure to cash, especially in the case of life insurers. When cash needs exceed available cash, insurers will use the repo market to monetise assets (and will implicitly be able to avoid forced sales of assets). Therefore, the disappearance of the repo market, combined with the lack of viable alternatives, could threaten the liquidity "tools" of long-term investors and create serious problems in periods of market stress, where forced sales, as the ultimate solution for gathering cash, would have a pro-cyclical effect.

An FTT on repos would have deleterious effects on the repo market. The average fee for a repurchase agreement is in the order of 0.05% per year. Since a minimum FTT would be 0.6%, taking into consideration the cascading effect, this could result in a substantial reduction in activity in the repo market.

In a typical repo transaction, an insurer buys securities that the counterparty has promised to repurchase, also known as a "reverse repo". This is, in essence, a substitute for the insurer depositing funds with a bank. It is more attractive because a repo is secured, whereas deposits are unsecured.

In this case, such reverse repos would cease to be available, thereby significantly increasing the insurance sector's risk in the banking sector, as the alternative would be to hold cash unsecured in either money market deposits or in deposit accounts at banks. It is worth noting that repo transactions are more attractive than

⁸ Directive 2002/83/EC of the European Parliament and of the Council of 5 November 2002 concerning life assurance (OJ L 345/1)

deposits as, in contrast to deposits, they are secured. Furthermore, in the case of a bankruptcy, the repo lender would be able to sell the assets it has been pledged to offset the money it has lent.

Furthermore, Insurance Europe would like to highlight the impact of repo transactions on the derivative market. As explained above, insurers use derivatives to manage their own balance sheets and shelter long-term savers from market volatility. Therefore, the reduction of the repo market would have a damaging effect on the liquidity and accessibility of the derivatives market.

Insurers also use stock lending (a transaction economically equivalent to a repo) as a means of generating low risk additional returns on their investment portfolios. Stock loans are collateralised transactions which generate incremental investment returns. Stock lending activity generates additional liquidity in the securities markets, and this in turn contributes to more efficient settlement and price discovery. While insurers are generally long-term holders of securities, active and efficient secondary markets are essential for such investors, reducing risk (in the event that securities are required to be sold before maturity) and supporting more confident asset pricing (for more accurate valuation of investment portfolios). The FTT as currently proposed would render the vast majority of stock lending uneconomic.

Finally, Insurance Europe would like to reiterate that the FTT proposal puts at risk the implementation of the EMIR Regulation. While EMIR allows for highly liquid assets to be used as collateral for both initial and variation margin calls, current practice indicates that clearing houses will only accept cash as variation margin. Hence, given the limited exposure that (life) insurers have on cash, it is important that other regulatory developments, such as the FTT, do not further amplify the cash concerns by limiting the access to the repo and stock loan markets. In the case of initial margin, where clearing houses will accept other liquid assets (such as corporate or government bonds), investors would incur the FTT charge for simply posting initial margin with a clearing house. In conclusion, the new FTT rules could create an additional financial burden on the use of derivatives for insurance companies. This, in turn, risks threatening the provision of insurance companies with long-term business, for some of which derivatives are vital.

V. Procedural considerations.

1) Joint liability for the payment of FTT

There should be no joint liability for the payment of FTT.

We understand that the idea of the joint liability for the payment of the FTT is mainly based on the fact that in most cases it is easier for FTT-zone member states to collect the FTT from entities that already have a presence in the relevant FTT-zone.

However, the lack of possibilities of fiscal enforcement in third countries should not be compensated at the expense of financial institutions established in the participating member states. This is likely to impose additional burdens on businesses such as insurance companies established in the participating member states. Where a financial transaction involves multiple financial institutions, of which all but one is established in non-FTT jurisdictions, the financial institution established in the FTT jurisdiction would be liable for multiple FTT charges.

This matter could be largely resolved if, as is the case with the French FTT and UK Stamp Duty, the FTT were:

- only payable by one party, eg the Purchaser; and
- payable via brokers and intermediaries.

Furthermore, the joint and several liability rule suggests that where the financial institution outside the FTT zone acts for a customer inside the FTT zone, that customer can be held liable for any tax not paid by the financial institution. This clearly runs contrary to the Commission's original policy objective of collecting revenue from financial institutions.

2. Harmonized implementation of the FTT.

The FTT should be implemented in a harmonised way. In particular, a uniform tax rate should be applied.

Insurance Europe is concerned that each participating member state may introduce different tax rates and differing rules regarding the joint liability for the payment of the FTT. Furthermore, the Proposal gives participating member states the power to specify the obligations with regard to registration, accounting and reporting, etc. Insurance Europe is concerned that it is very likely that different rules would apply across member states which, in turn, would produce a complex tax collection system. Moreover, it would cause further fragmentation of the internal market and create market distortions between member states.

Furthermore, in Insurance Europe's view, instead of the intended split of a minimum tax rate of 0.1% and 0.01%, a uniform tax rate of a maximum 0.01% should apply in order to prevent tax arbitrage. Such a maximum tax rate would still yield significant tax revenues. Different tax rates would lead to fiscal structuring of products.

Here, we would like to draw attention to the fact that it is not clear how to apply the FTT in relation to structured products (eg security + derivative). In particular, it is unclear whether the transaction should be taxed at 0.01%, at 0.1% or at a mixture of the two rates following separation of the product's components. While in many cases such a separation should not be too difficult and burdensome, in other cases it will be, and the time and resources associated with it could be disproportionately large.

3. Start date and administrative issues.

The FTT should be delayed to enable appropriate changes to be made and the FTT should be payable via brokers and other intermediaries.

The proposed FTT is a new tax. Insurers have no existing systems for identifying and collecting such a tax, as existing transaction taxes such as UK Stamp Duty and the French FTT have narrower tax bases and are paid via brokers and intermediaries. Complying with the reporting and payment obligations of 11 different FTT-zone member tax authorities would be burdensome and inefficient. Should the participating member states decide to move ahead with the FTT, new reporting systems would have to be designed and developed, and it would take considerable time for insurance companies to adapt. Payment should therefore be made via brokers or other intermediaries.

Furthermore, the current proposal requires the monthly submission of returns. For a financial institution based in all 11 FTT states, 132 additional tax returns would need to be filed each year. Given that the FTT would be payable almost automatically, there seems to be no need for such regular returns, and a single annual return would substantially reduce the administrative burden but not reduce FTT revenues.

Finally, complying with the proposed FTT would be especially burdensome for parties based in non-participating member states. Those financial institutions would only know if they were liable to pay the tax and at which rate if they know their counterparty's residence. However, the current trading systems are not adapted to provide that kind of information today, as trading platforms are based on anonymity. Moreover, individual transactions are not matched one-to-one but rather processed in larger batches. In addition to a high risk of fragmentation of the internal market, the administrative burden resulting from adapting all existing systems would be significant, especially for the financial institutions established outside the FTT area that do not trade regularly with the FTT area.

Appendix 1

Insurance Europe comments on the Commission's stated objectives for the FTT

Insurance Europe believes the Proposal will not meet the objectives set out by the European Commission. The below provides an overview of the key considerations in this regard.

1. The Proposal intends to ensure a proper functioning of the Internal Market through harmonising legislation concerning indirect taxation on financial transactions.

Rather than enhancing the functioning of the internal market as required under enhanced cooperation, the proposed FTT Directive could disrupt its functioning with respect to financial services by increasing both the differences in market conditions and the risk of double taxation between member states.

The introduction of the FTT via enhanced cooperation would lead to a competitive disadvantage for jurisdictions that are subject to an FTT regime.

The need for competition at arm's length between institutions led the Commission to propose provisions concerning the application of the FTT according to the principles of "residence" and "issuance". Those provisions rightly try to avoid the circumvention of the tax by non FTT-zone parties and to solve competition issues, however they would also result in unintended effects that highlight the inappropriateness of a non-global FTT. Indeed, under the proposed residence principle, there would be a direct barrier to trade with the participating member states as a financial institution established in a non-participating member state, by entering into transaction with a financial institution established in participating member state, is liable to pay an FTT. Likewise, on the basis of the issuance principle, financial institutions established outside the FTT jurisdiction would be discouraged from transacting in securities issued in the FTT area. Therefore, financial institutions established in non-participating member states would essentially (1) avoid transacting with FTT-zone counterparties; and (2) avoid transacting in securities that have FTT-zone issuers. In consequence, the proposed Directive fails to achieve the objective of the enhanced cooperation procedure of reinforcing the internal market.

To give an idea of such a distortion of the internal market, let us provide two examples:

(1) One member located outside the FTT-zone currently uses an FTT-based bank as its main broker/intermediary when acquiring investment assets, both within and outside the EU. As a result of the proposed Directive the FTT would arise on those trades that could be simply avoided by switching to a UK, US, Swiss or other non-FTT based bank, reducing the value of the FTT-zone financial sector.

(2) Another member, based in the FTT-zone is competing with non FTT-zone insurance companies for customers based in the non FTT-zone. After the introduction of the transaction tax, the FTT-zone insurance company will be subject to the tax while the non FTT-zone insurance company will not, which will lead to distortion of competition.

These examples show that the FTT could result in two effective single markets in the EU, one in the FTT zone, and one outside, with the outside single market able to operate more effectively.

Furthermore, the FTT increases the takeover risk of FTT-based insurers. The FTT would currently apply to all branches of an EU-based financial institution, including those based outside the FTT zone. This would mean that on acquisition by a non FTT-zone financial institution, there would be an immediate cost synergy for the acquirer as those non FTT-zone branches would suddenly be exempt from an FTT charge they were paying, and hence there would be an increased likelihood that FTT-zone insurers would become takeover targets, and the focus of those businesses would in time shift outside the FTT zone.

Finally, given the existing situation created by some EU member states that have already introduced a transaction tax at national level and do not intend to join the proposed FTT Directive, it is difficult to see how an FTT could resolve the double taxation issue. Double or multiple taxation situations can only be avoided if two or more taxes are applied to the same taxable base (eg profits) and this is not the case in respect of the proposed FTT and existing national transaction taxes in the EU. Therefore, where for instance a German



financial institution purchases shares issued by a UK-based company, it may be subject to both the FTT and UK stamp duty.

2. The proposal aims to ensure that the financial sector makes a fair contribution to public finance in recognition of the fact that it is currently under-taxed by comparison to other sectors as a result of the VAT exemption.

The proposed FTT intends to 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 proposed Directive fails to take into account that the insurance sector bears the significant costs of hidden VAT and already contributes substantially to member state budgets, notably through insurance premium taxes (IPTs) and parafiscal charges.

Under its fundamental principles, VAT is a pure consumption tax, which ultimately is borne by consumers, not by businesses. Insurance companies suffer irrecoverable VAT as a result of their supplies being exempt from VAT. This is an absolute cost to businesses and is trapped as a cost component of the onward exempt supply. The burden of irrevocable VAT paid by insurance companies cannot be regarded as low. By way of example, in France irrevocable VAT paid by insurance companies amounted to 1.3 bn €⁹ in 2010.

It is worth noting that since the beginning of the financial crisis 10 member states (Cyprus, the Czech Republic, Finland, Hungary, Ireland, Italy, Poland, Portugal, Romania and the United Kingdom) have increased their VAT rates. As explained above, for the insurance sector increased VAT rates means a higher burden of irrevocable VAT. Furthermore, with increases in the VAT rate already announced in other member states, eg France in 2014, the VAT contribution of the insurance sector is expected to rise.

Furthermore, as mentioned above, the proposed FTT Directive does not take into account IPTs, which were introduced to ensure the consumption taxation of insurance services in the context of the VAT exemption of those services. This clearly differentiates the insurance sector from the banking sector, where a comparable tax does not currently exist. Europe-wide, the insurance industry contributes a significant amount to national budgets through IPTs (eg, in 2011, Germany €10.8bn, France €5.9bn, Italy €5.5bn, Austria €2.7bn, Spain €1.4bn). Insurance companies also contribute through additional contributions based on premiums, ie, parafiscal charges on premiums (eg, in 2010, France €3.5bn, Italy €1.8bn, Belgium €898m).

There has been a trend for European governments to increase IPTs and parafiscal charges. For example, since 2008-09, Bulgaria and Slovenia have introduced IPTs, and Denmark, Finland, France, Hungary and the Netherlands have increased their IPT tax rates. It is also worth noting that from a compliance point of view the significant variations in IPTs between member states, with different information requirements on IPT returns, creates an extra administrative burden and cost for insurance companies operating across the single market.

The FTT would cause certain activities that boost tax revenues to cease. Ordinarily, many life assurance groups seek to boost their investment returns by either stock lending or repo trades, involving their investment assets. These typically generate additional fee income of between 5 and 10 basis points, which would ordinarily be subject to corporate income tax.

The FTT charge on such transactions would negate that additional fee income. Therefore, the inclusion of insurers' repo or stock lending trades within the FTT provisions would result in the discontinuation of a profitable activity which also aids the wider economy by facilitating bank lending. The loss of fee income on such activities would also result in a corresponding loss of corporate tax revenues on that income.

Finally, insurance and reinsurance companies are subject to the corporate taxes applicable in the countries in which they are established. The insurance sector is a large corporation tax payer, for example in 2010 results showed that the UK insurance sector was the third largest corporation tax paying sector¹⁰. Insurance companies are also limited claimants of certain tax incentives, eg, research and development credits; suffer

⁹ Based on Insurance Europe's calculations

¹⁰ ABI research paper No 23, 2011 "Total Tax Contribution" page 12

from the increasing restrictions on use of brought-forward tax losses, and due to regulatory requirements cannot structure themselves in highly tax efficient manner in the way that, for example, internet-based industries do.

3. The Proposal is meant to limit undesirable market behaviour and to stabilise markets.

The proposed FTT Directive is meant to limit undesirable market behaviour and to help stabilise markets. However, the proposed FTT does not specifically target activities that distort the markets, such as purely speculative transactions. By virtue of this non-differentiation between speculative and non-speculative transactions, the FTT would in fact amplify distortion and incentivise riskier transactions. The tax would make many low-margin, low-risk transactions unviable, and would accentuate the benefits of high-margin, high-risk transactions, for example, there is a financial disincentive to derisk by reducing exposure in equities or other higher risk instruments and increasing holdings of government debt as this would incur an FTT charge.

According to the *de Larosière Group*¹¹ and IMF¹² report, the crisis has its origins in macro-economic imbalances; failures in the assessment of risk by certain firms and supervisory authorities; the functioning of Credit Rating Agencies; corporate governance failures; and regulatory, supervisory and crisis management failures.

This variety of reasons leads to the conclusion that what is really needed are not new/additional taxes or single measures, but rather a new global regulatory supervisory environment which seeks to correct the weaknesses of the past and anticipate possible future crises. Therefore, in Insurance Europe's view, potential market inefficiencies or possible systemic risks should be addressed by policymakers through appropriate financial market regulation and supervision and not through an FTT.

In Insurance Europe's view, any tax measure aimed at addressing regulatory gaps should be assessed against existing and envisaged regulatory measures. Focusing on tax measures and regulatory measures in parallel, without due consideration for both aspects, could lead to unintended consequences.

It is worth noting the significance of the newly adopted Solvency II provisions for the insurance sector. Solvency II will enhance risk management in insurance companies, improve their capital allocation and strengthen their ability to resist crises such as the recent one. In particular, the good risk-management incentives provided by the risk-based approach of Solvency II will ensure that each investment is backed by appropriate capital, both in terms of quantity and quality. In this respect, Solvency II should contribute to a safer financial sector, which is one major objective of the Commission with its proposal on the FTT. Solvency II is already a huge human and financial challenge for the insurance sector.

Finally, in the context of the EC objective of reducing excessive risk-taking, it needs to be underlined that insurers perform a valuable social function by arranging the transfer of risk for a premium. As a result, for the insurance sector, concepts such as "excessive risk-taking" or of taking "too much risk" have little relevance: the fundamental consideration is adequate pricing of risk. Through their activities, such as providing individuals and firms with protection against financial risk that they do not want to face by themselves, insurance firms benefit the economy at large. In many areas, such as environmental liability, carbon capture and storage, cross-border healthcare and alternative investment management, the Commission and national governments have sought to persuade insurers to assume more risk. Furthermore, reinsurance is a method by which insurers themselves can subsequently manage the risks assumed. Levying the FTT charge on the insurance sector would hinder, rather than assist, risk management across the European economy.

¹¹ The report of the High-Level Group of Financial Supervision in the EU chaired by Jacques de Larosière, 25 February 2009.

¹² A fair and substantial contribution by the financial sector, June 2010.



Insurance Europe is the European insurance and reinsurance federation. Through its 34 member bodies — the national insurance associations — Insurance Europe represents all types of insurance and reinsurance undertakings, eg pan-European companies, monoliners, mutuals and SMEs. Insurance Europe, which is based in Brussels, represents undertakings that account for around 95% of total European premium income. Insurance makes a major contribution to Europe's economic growth and development. European insurers generate premium income of almost €1 100bn, employ nearly one million people and invest around €7 700bn in the economy.