GFIA Comments on an EU FTT under Enhanced Cooperation

Introduction

The Global Federation of Insurance Associations (GFIA) opposes the Commission's draft proposal ("Proposal") implementing enhanced cooperation in the area of financial transaction tax ("FTT"). GFIA believes that the Proposal would have far-reaching global consequences on the insurance sector beyond the participating EU Member States. This letter raises concerns over the extraterritorial reach of the proposed FTT and its negative impact on the insurance sector globally.

General remarks

GFIA's overarching concern is that the introduction of the proposed FTT would have a significant impact on economic growth and therefore undermine countries' efforts to sustain economic recovery and ensure job creation. Specifically, the proposed FTT would result in significantly less liquid financial markets and higher costs on financial intermediaries, which, in turn, would increase the cost of funding of companies and therefore negatively affect their future levels of investment in the economy.

Moreover, GFIA believes that, even if insurance contracts are excluded from the scope, the proposed FTT would have a significant adverse impact on insurance companies and their customers. In particular, by taxing the transactions of all types of financial instruments, irrespective of whether they are conducted for a speculative or investment purpose, the Proposal would significantly increase the cost of policyholder protection (as the price of an insurance policy is dependent on the investment return) and would inevitably reduce the return offered on long-term retirement products and increase the cost of life insurance products provided by insurance companies. This in turn could have consequences for the economy, since insurance companies are important long-term investors, and have a key role to play in contributing to economic growth. We are very concerned that ultimately, the substantial cost of an EU FTT would be paid by consumers, as outlined by the International Monetary Fund in its June 2010 report *"A fair and substantial contribution by the financial sector".*

Therefore, GFIA believes that the Proposal is not only highly likely to hamper the economy, but would also give rise to significant costs on long term savings which would, in reality, be borne by consumers.

Application of the Proposed FTT

The proposed FTT would lead to a competitive disadvantage for companies from jurisdictions subject to the FTT. Additionally, the introduction of the proposed FTT in only some European countries would result in significant extra-territorial effects. More specifically, the proposed tax would have the following negative consequences:

1) Given that the Proposed FTT is not global, it would result in an unlevel playing field and distort the marketplace. Under the proposed *residence principle*, there would be a direct barrier to trade with the participating Member States since a financial institution established in a non-participating country would be liable to FTT by transacting with a financial institution established in a participating Member State. Similarly, 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 avoid transacting (i) with FTT Zone counterparties and (ii) in securities that have FTT zone issuers.

2) Financial institutions in the FTT area would be placed at a significant competitive disadvantage compared to global competitors, as can be seen in these examples:

   a. A company 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. Under the Proposed FTT, FTT would arise on those trades. The FTT 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.

   b. An insurer based in the FTT-zone competes with non FTT-Zone based insurers for customers based outside the FTT-zone. Under the proposed FTT, the FTT-zone based insurer would be subject to the tax while the non- FTT-Zone based insurer would not, which would lead to an unlevel playing field.

   Furthermore, FTT increases the takeover risk for FTT based insurers. Under the current proposal, FTT would apply to all branches of an FTT-zone based financial institution, including those branches based outside the FTT zone. On acquisition by a non-FTT zone financial institution, there would be an immediate cost synergy for the acquirer as the non-FTT zone branches would be exempt from FTT. This would increase the likelihood that FTT zone insurers would become takeover targets, and their operations would in time shift to outside the FTT zone.

3) The implications of the FTT for financial institutions established outside the FTT area could be substantial as well. This can be demonstrated by the case of a Canadian insurer headquartered in Toronto (with no subsidiaries in countries applying the FTT) and a Japanese bank headquartered in Tokyo (with no subsidiaries in the FTT-zone) engaging in a transaction on shares issued in Germany and concluded in a market established in a non-FTT jurisdiction (e.g.in London). Under the issuance principle, both the Canadian insurer and the Japanese bank would

pay the German FTT, even if the transaction was negotiated and executed outside the FTT jurisdiction.

4) There is a high risk that the unilateral adoption of the FTT by 11 European countries could lead to double taxation. Double tax situations can be avoided only if two or more taxes are applied to the same taxable base (e.g. profits), however this is not the case with the proposed FTT and existing national transaction taxes. 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 the UK stamp duty.

5) Finally, GFIA would like to point out that complying with the proposed FTT would be especially burdensome for parties established outside the FTT area. Those financial institutions would know if they are liable to the tax (and on which rate) only if their counterparty's residence is known. However, the trading systems currently being used do not provide that kind of information, as they often operate on the basis of anonymity whereby the trading partners do not know each other. Transactions executed on the trading platforms are not matched one-to-one against each other but are instead processed in larger batches. The administrative burden and costs resulting from systems changes in order to clearly identify counterparties and their residence would be immense.

The attached Annex outlines in more detail the negative impacts of the proposed FTT on insurers and their products, particularly retirement products.

Conclusion

The proposed FTT would have an adverse impact on insurers and financial markets and the economy more broadly as well as on corporations' ability to raise funds to invest in job-creating plant and equipment and on consumers and their ability to save for retirement and provide financial protection for their families.

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The Global Federation of Insurance Associations (GFIA) was established on 9 October 2012. Its 32 member associations represent insurers that account for around 88% of total insurance premiums worldwide.

GFIA is a non-profit association established to represent national and regional insurance associations that serve the general interests of life, health, general insurance and reinsurance companies and to make representations to national governments, international regulators and others on their behalf. The federation:

- represents member association's interests to, among others, international regulatory groups, standard-setters and governments to increase the industry's effectiveness;
- contributes to an international dialogue on issues of common interest by formalising contact, cooperation and dialogue among national and regional insurance associations;
- co-operates with other international organisations, particularly those representing the insurance industry;
- shares non-commercially sensitive information and research; and
- provides information on positions taken by the federation.

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ANNEX

Specific concerns for the insurance sector

Against the above background, GFIA believes that the Proposal should be profoundly amended to minimise the negative impact on long term savings rates and economic growth. The following key concerns should receive careful consideration:

Impact of the FTT on retirement savings: GFIA regrets that the Commission's proposal and its impact assessment disregard the intentions of governments in the EU, and around the world, to reinforce the development of complementary retirement savings and improved financial security more generally. Due to demographic changes, many jurisdictions have shifted from predominantly public Pay-As-You-Go (PAYG) pensions to multi-pillar complementary, funded schemes. In this respect, private complementary retirement savings are indispensable for meeting the challenges of numerous countries to address the problems presented by ageing populations. Imposing an additional tax on retirement and other long-term insurance savings products is inconsistent with promoting retirement savings.

Furthermore, imposing a tax on retirement products would undermine the Commission's stated objectives of targeting only certain high-risk financial transactions.

GFIA therefore regrets the Commission's decision to include all private and occupational pension products, as well as life insurance products, under the FTT regime, and recommends that these products be exempted.

Impact on bonds: In GFIA's view, imposing the FTT on the secondary bond market would significantly reduce investment returns for insurers and increase the cost to corporations and governments of debt financing and related investments in the economy and government spending. Although the Commission's proposal exempts primary market transactions from the FTT, the primary market is intrinsically linked to the secondary market, which is subject to the tax.

Imposing the FTT on the secondary bond market would affect the attractiveness of medium and long-term bonds as investors would know that these bonds would no longer be "vendible", and they would implicitly require an illiquidity premium as compensation for having to hold the bond until its maturity. As a result, issuers of debt would need to compensate investors for the expected FTT charges on the secondary market by offering significantly higher returns. It is worth also mentioning that corporate bonds are often traded via intermediaries, so the FTT charge would escalate depending on the number of intermediaries involved. This would also increase the cost of capital for the non-Financial Sector~~.~~

Accordingly, GFIA believes that bond transactions on the secondary market should be excluded from any FTT regime.

Cascading effects: GFIA notes that the Commission's proposal can lead to cumulative taxation at each stage of a single transaction regardless of the economic context of the traded product. This is the result of a chain of trading and clearing that lies behind most securities transactions, which usually involves various stages of trading and settling.

GFIA is especially concerned with the impact of the "cascading effect" on equities, as financial intermediaries play a crucial role in matching orders and providing liquidity in the equity market. For example, a purchase of securities on a Stock Exchange ordinarily involves the sale and purchase by a number of parties, including brokers, clearing members and the clearing system. An equity sale from seller to clearing broker, central counterparty, clearing broker and buyer could lead to up to 6 charges if both the seller and buyer are financial institutions. This assessment is conservative in our view, and ignores issues such as intra-bank transfers, or collateral costs.

Although this problem is recognized, GFIA feels that the cascading effect of the tax within a single transaction is not sufficiently addressed by the Proposal, and believes that the proposed FTT must be amended to prevent multiple taxation of a single transaction.

Derivative contracts: The proposed taxation of derivatives should be reconsidered. In particular, GFIA is concerned that by taxing the notional value of a derivative contract, the FTT would have a considerable impact on insurers' ability to ensure efficient asset management and control risk, and would effectively eradicate the European derivatives market over time.

Derivative instruments are used by insurers to ensure that their assets match their liabilities. As long-term investors, insurers cover their long-term liabilities by investing in long-term assets. Ideally, a mapping between the profile of insurers' liabilities and the profile of their assets should be achieved by investing in assets with the appropriate risk, return, maturity and liquidity characteristics. However, it is often the case that the assets required to fully cover the liability exposure are not available and insurers therefore replicate these exposures by entering into a derivative contract, such as a swap.

Therefore, GFIA strongly believes that the proposed taxation of derivatives should be reconsidered.

Intra-Group transfers: Under the Commission's proposal, transactions within groups would be subject to the FTT. It is common practice for insurers and re-insurers to transfer part of their businesses in the form of contracts within an affiliated group to spread risk and carry out their business activities. In some cases, these transfers are imposed by regulators as precautionary measures. Taxing intra-group transactions would create undue constraints on transfers within corporations across and within the FTT jurisdiction.

Therefore, intra-group transactions should be excluded from the FTT's scope.

Repo and stock lending trades: GFIA would like to point out that applying the FTT on repos would threaten liquidity and long-term asset-liability and risk management. As explained above, since insurance policy liabilities are long-term and illiquid, it makes sense for insurers to match them with long-term assets, which are often illiquid, and to minimize cash holdings in order to maximize investment returns. When cash needs exceed available cash, insurers frequently use the repo market to monetize illiquid assets (and avoid forced sales of long-term assets).

Therefore, GFIA believes that repo and stock lending trades should fall outside the scope of any FTT.

Non-harmonised implementation: GFIA 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 requirements with regard to registration, accounting and reporting amongst others. GFIA is concerned that it is very likely that different rules would apply across Member States which, in turn, would consequently produce a complex tax collection system and increased compliance burdens.