ICMA International Capital Market Association

ICMA EUROPEAN REPO COUNCIL

16 April 2013

Response to comments on the ICMA ERC's 8 April report on the Commission's proposal for Financial Transaction Tax (FTT) under Enhanced Cooperation

With reference to statements reportedly made by the European Commission after the publication of the ICMA ERC's 8 April FTT report[i] we would like to clarify a couple of points.

1. We fully recognise that the proposal is for the tax to be applied once on each transaction. However, that simple statement does not clearly reflect the cost of the proposed tax.

   Firstly, consider the simple case of a repo transaction which consists of "two legs", i.e. a sale at the start date and a repurchase at the maturity date. The Commission's concession allows that FTT only needs to be paid at the start date and not again at the maturity date. But, when two market participants conclude a repo transaction with each other, both parties pay the tax. In other words, two amounts of tax are being levied on the same transaction.

   Secondly, consider the case that is in fact examined in the numerical illustration set out in section #5 of the ERC's paper. This examines the costs imposed on a market-maker who seeks to earn a bid-offer spread by standing between two market participants. It is inherent in the performance of this function that the market maker suffers two FTT charges, one on each side of the market. This cost, as is illustrated, entirely swamps any potential returns from bid-offer on shorter term transactions, forcing the market-maker to cease playing the role. This in itself leads to the adverse repercussions described in the ERC's paper. But even where market participants could find each other and transact directly without such market-making intermediation, there would be two FTT charges, as described in the first case above.

2. As for other short-term financing possibilities for business, the Commission is again being over-simplistic when it asserts that these are free of tax and hence avoid any financing problems.

   Given the existing prohibition on the taxing of capital raising, the issuance of Commercial Paper (CP) in the primary market, which is executed by dealers, should not be subject to tax, but the current drafting of the FTT proposal does not appear to respect this fact. In addition, any secondary market transactions in CP and also in Certificates of Deposits (CDs) would be subject to the FTT. In each case, the scale of this tax cost will entirely swamp the economic returns available to those providing the impacted primary dealing and market-making services and they will be forced to cease the provision of such activities. The removal of secondary market liquidity would make CDs redundant; and would cause many CP investors to step out of the market, since they will not be able to commit to always holding the paper until maturity, and the cost of issuing such paper will increase accordingly.

Furthermore, the Commission's proposals to replace repos with central bank repos and secured loans are also problematic, as elaborated in paragraphs 7.14 – 7.17 of the ERC's paper. The effect of the Commission's proposal is to push for unsecured financing to become the main tool for the real economy, which contradicts the prudential regulation as implemented under the Basel provisions and more recent measures such as EMIR, reversing 25 years of evolution in the reduction of systemic risk.

Yours faithfully,

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Chairman
ICMA European Repo Council

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[i] On 8 April 2013, the International Capital Market Association's (ICMA's) European Repo Council (ERC) called for the exemption of repo transactions from FTT. In support of this call, the ICMA ERC published "*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*", a study, authored by Richard Comotto, Senior Visiting Fellow at the ICMA Centre, Henley Business School, University of Reading.