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ESBG Statement: Financial Transaction Tax

ESBG is concerned regarding the ongoing discussions on the possible introduction of a financial transaction tax (FTT) on fixed income instruments, FX instruments and equity. The impact on financial activities essential to the functioning of financial markets and to the real economy would be negative and would become a reality even with a step-by-step introduction of the tax starting with equities. More specifically, we believe that all of the following will be impacted negatively by the proposed tax:

- the issuance of and secondary markets for sovereign bonds;
- the use of derivatives contracts for hedging purposes;
- the use of repurchase agreements to provide secured liquidity to the market;
- market-making activities;
- the use of intra-group transactions for liquidity management and efficient capital allocation within a group.

Our main concern with the current FTT proposal is that, in efficient fixed income markets, such as the markets for government and covered bonds, which are characterised by low spreads between bid and offer prices, the tax will be far higher than what can be earned on market making, especially on instruments with short remaining time to maturity. We are concerned that a drop in trading volumes in equity markets (as already experienced with the introduction of national FTTs within different Member States) will further impede liquidity. The consequence of the tax will be that market making will almost cease and the current liquid markets are likely to be transformed into buy and hold markets. As a result market liquidity will disappear or be significantly reduced. This in turn will have many negative consequences, e.g:

- higher funding costs, especially for governments and issuers of covered bonds (i.e. in the currently most liquid markets);
- reduced ability for banks and private sector actors to hedge financial risks and as a result higher volatility in earnings (i.e. higher risk levels both in banks and in the "real economy"), which in turn will hamper the growth of the real economy;
- the potential for developing market-based measures to increase the supply of funds for long-term investment will be significantly reduced;
- there will be fewer financial instruments that fulfil the requirements for being included in bank liquidity reserves;
- accounting will be less transparent since it will be harder to determine fair values because trading will be less frequent and prices more volatile.

These negative consequences will be most visible in the area of participating Member States but will also be significant in non-participating Member States, since market-makers in these countries often trade in instruments and with counterparties from the FTT area in order to mitigate the risks associated with trades in their domestic instruments and counterparties. This is the case both for non-participating euro and non-euro Member States.

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