ISDA® Safe, Efficient Markets

19April 2011

European Commission
Taxation and Customs Union DG
B-1049 Brussels

Dear Sir/Dear Madam,

Consultation Paper on the Taxation of the Financial Sector

The International Swaps and Derivatives Association's (ISDA) European Tax Committee welcomes the opportunity to contribute towards the European Commission's consultation on the taxation of the financial sector.

Since its founding in 1985, ISDA has worked to make over-the-counter (OTC) derivatives markets safe and efficient. ISDA's pioneering work in developing the ISDA Master Agreement and a wide range of related documentation materials, and in ensuring the enforceability of their netting and collateral provisions, has helped to significantly reduce credit and legal risk. ISDA has been a leader in promoting sound risk management practices and processes, and engages constructively with policymakers and legislators around the world to advance the understanding and treatment of derivatives as a risk management tool. Today, ISDA has more than 800 members from 55 countries on six continents. These members include most of the world's major institutions that deal in privately negotiated derivatives, as well as many of the businesses, governmental entities and other end users that rely on OTC derivatives to efficiently manage the financial market risks inherent in their core economic activities. ISDA's work in three key areas – reducing counterparty credit risk, increasing transparency, and improving the industry's operational infrastructure – show the strong commitment of ISDA toward its primary goals; to build robust, stable financial markets and a strong financial regulatory framework.

The comments in this response reflect the global nature of ISDA and its members.

ISDA response: key message

ISDA has had the opportunity to review the detailed response to the consultation by the Association for Financial Markets in Europe (AFME) and the British Bankers' Association (BBA). Many of ISDA's members are also members of these associations. ISDA agrees with the detailed submissions made by AFME and BBA and wishes to take the opportunity to reiterate the comments made in the AFME and BBA responses. As a result, ISDA will not respond specifically to each question set out in the consultation.

International Swaps and Derivatives Association, Inc.
One Bishops Square
London E1 6AD, United Kingdom
P 44 (0) 20 3088 3550 **F** 44 (0) 20 3088 3555
www.isda.org

NEW YORK WASHINGTON
LONDON BRUSSELS
HONG KONG SINGAPORE
TOKYO

However, ISDA would like to make some high level responses to the consultation from the perspective of the European derivatives market, particularly in relation to the broad based financial transaction tax (FTT) which could apply to European derivatives business.

(i) Current tax contributions by the financial sector

We do not consider the financial sector to be under-taxed. The financial sector is a significant contributor to tax receipts across Europe. As well as taxes on profits, payroll taxes and other taxes borne by the financial sector in common with other industries, in recent times further taxes and/or levies have been imposed on financial institutions in Europe (such as the UK bank levy). Further, the financial services value added tax (VAT) exemption increases the tax cost base of the financial sector (by limiting the sector's ability to recover VAT on costs borne by the sector) rather than reducing the tax base.

Consequently, we consider that the financial sector already bears a higher tax burden than other industries and business areas.

(ii) Impact of a FTT

There has been much recent publicity concerning a so-called Tobin tax or Robin Hood tax and this is reflected in the reference to a broad based FTT in the consultation. Despite the publicity, there seem to be few details of how such a tax would work or be operated in practice, precisely how the FTT might be calculated and where the burden of this additional tax might fall. It is therefore difficult to provide detailed analysis of its impact (see for example Question 13 of the consultation). However this response sets out ISDA's views on the high level impact of any such FTT however it is structured or imposed.

(a) Incentive to relocate derivatives business outside Europe

Introducing new taxes on the financial sector in Europe alone risks forcing a migration of derivatives business out of Europe and away from newly created European derivatives exchanges and settlement mechanisms. The likely destination for this mobile business would be less well regulated countries outside Europe.

A broad based FTT on derivatives, if this were imposed unilaterally on derivatives written from Europe, would create a distortion of competition between European and non-European institutions and branches. For example, a financial institution with branches in the US, Europe and Asia would be able to offer a cheaper derivative (i.e. with no FTT) if it wrote derivatives business to customers from its non-European locations. A financial institution with no such branches or affiliates outside Europe would be placed at a competitive disadvantage to its counterparts elsewhere in the world and would be incentivised to set up new offices outside of Europe from which to write derivatives business.

Our concern is that any tax which is non-global in its application would provide a clear incentive to push derivatives business away from Europe and would almost inevitably have the effect of relocating current derivatives business outside the regulatory scope and fiscal net of Europe and its member states.

This incentive comes both from:

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(a) customers, who will naturally seek the lowest costs from the financial institution writing the derivative; and

(b) financial institutions, who are likely to respond to this demand by keeping their cost base as low as possible, including by writing derivatives from Hong Kong or Singapore affiliates or branches if appropriate, rather than passing the cost of a FTT onto customers if possible.

(b) Negative impact on derivatives industry and customers alike

Even if derivatives business remains in Europe, for example as a consequence of the tax being imposed globally by the G20 and all other major financial markets, we still anticipate that it would cause problems for the financial sector and corporates alike.

Even leaving that to one side, the derivatives industry provides important risk management tools helping to achieve growth in the economy. The derivatives industry serves a variety or large, medium and small corporations and entities, which use derivatives products to manage interest rate, currency, credit and counterparty risks.

We believe that managing such risks is essential for the long-term economic growth and recovery of European economies. However, we are concerned that imposing new taxes on or in relation to derivatives increases the cost base of operating a derivatives house or purchasing derivative protection and ultimately increases the costs across many industries on all market participants in the derivatives industry. Economically, that cost would either be borne by the financial institution writing a derivative or be passed on to the customer (or shared between the derivative parties). A FTT is therefore an artificial disincentive to hedge risk.

Introducing new taxes on the financial sector also risks reducing the capital base of financial institutions at a time when regulators are demanding higher capital buffers. If the additional cost is simply passed on to customers, this would act as a barrier to accessing the financial markets, as well as restricting liquidity (and therefore increasing volatility) in those markets.

(iii) Impact on tax revenues

A broad based FTT which includes derivatives in its scope would, ISDA believes, be an inappropriate and ineffective means of levying new taxes in order to increase tax revenues.

The relocation of derivatives business outside Europe (as described in (ii) above) would result not only in a lower amount of FTT being collected (on the basis that swaps and derivatives may be entered into outside of Europe instead), but could also reduce the amount of corporate taxes being collected by member states (on the basis that revenues and profits currently generated in Europe in relation to swaps and derivatives may arise outside of Europe instead). It could also have the consequence that derivatives are written away from the regulatory framework of the European Union and instead in other markets.

(iv) Financial Activities Tax

A narrow based FTT (which did not include derivatives) or any of the Financial Activities Tax (FAT) alternatives would be unlikely to impact the writing of derivatives in such a direct way, but could have similar consequences because such additional tax increases the cost basis for the European financial sector (as well as potentially making the purchase of a hedge for the derivative more expensive for the financial sector).

(v) Conclusions

None of these outcomes seems to us to be consistent with the policy aims and objectives of the consultation. We therefore do not support the imposition of an FTT or FAT on the European derivatives industry at all and strongly urge against such new taxes, even if part of a globally co-ordinated effort. For the reasons outlined above, we particularly wish to highlight the damage which could be caused by a broad based FTT applying solely to European derivatives business.

Yours faithfully,

Martin Walker
Chair of ISDA European Tax Committee

Antonio Corbi
ISDA Tax and Accounting

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IDENTIFICATION OF THE STAKEHOLDER

- Name and address of the respondent, relevant contact details (including email address for contact)

Antonio Corbi,
ISDA® International Swaps and Derivatives Association, Inc.
www.isda.org
ONE BISHOPS SQUARE
LONDON E1 6AD
TEL: 020 3088 3560
FAX: 020 3088 3555
MAIN TEL: 020 3088 3550

- If you are registered with the Commission as an "interest representative"[1] your identification number

Identification number in the Commission register: 46643241096-93

- Field of activity of the respondent. Please specify your field of activity. Please. indicate if you are directly affected by any of the measures and if so, which one and to what extent:

ISDA is the trade association for the derivatives industry with head quarters in New York and London and offices in Washington, Brussels, Singapore, Tokyo and Hong Kong. ISDA is not directly affected by the proposals but is representing organisations which will be.

- If the respondent is an association of stakeholders, how many members do you represent and what is your membership structure?

ISDA has more than 800 members across the globe that hold banking licences from their respective Financial Services Authorities. ISDA is governed through a Board of Directors which meet regularly throughout the year.

- Do you object to publication of personal data on the grounds that such publication would harm your legitimate interests?

No

[1] https://webgate.ec.europa.eu/transparency/regrin/welcome.do?locale=en

- Do you agree to having your response to the consultation published along with other responses?

Yes