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The Not-So-Merry Robin Hood Tax

Editorial

The formal review of the Markets in Financial Instruments Directive and Market Abuse Directive is underway. In mid-October the European Commission published draft legislation – a directive and regulation in both cases – for the European Council and the Parliament. The proposals are fundamentally important. Not only do they underpin the framework in which the financial market activities represented by AMAFI are conducted. Also, and perhaps more importantly, they seek to correct certain shortcomings in the financial markets and restore their credibility, which has been seriously undermined both by these shortcomings and also by the crisis. The analytical work and the quest for alternative or complementary solutions undertaken by AMAFI, as reflected in this newsletter, will be taken forward with that fact in mind. This is because markets need the trust of issuers and investors in order to fully perform their role of financing economic activity and hedging risk. Regrettably, that goal may not be fully attained. Without a proper debate on the market model that Europe wants to adopt to meet the needs of its economy, the Commission's proposals raise a number of difficulties. These problems are all the more unacceptable because they will hamper the process of smooth, harmonised implementation needed to build an integrated market. The key issue for AMAFI in the months ahead will be to contribute to the deliberations of European institutions as they seek to clarify the legislative framework and ensure that it can meet its objectives effectively.

Pierre de Lauzun
Chief Executive, AMAFI

Feature

Increasing calls for a tax on financial transactions, including a draft EU directive, have triggered heated reactions, especially in Britain. Just how dangerous – or how beneficial – is the so-called Robin Hood Tax?

"A bullet aimed at the heart of London" is how UK Finance Minister George Osborne describes plans to tax financial transactions. The Adam Smith Institute, a free-market thinktank, warns that the City is being hung out to dry. A Conservative MP argues that the plan adds weight to a press campaign to get Britain out of Europe. And even the normally unflappable David Cameron, the UK prime minister, reportedly pondered asking the French if they would accept a cheese tax.

Yet the proposal by the European Commission to apply a small levy to stock, bond and derivatives trades hardly seems earth-shattering. So why the hostile reactions?

As the economic crisis worsens, pressure for the financial world to contribute to a solution has been building, notably in the run-up to the recent G20 summit in Cannes. For "contribution", read "taxation". On 28 September the European Commission published a draft directive on a common system of financial transaction tax (FTT).

Feature

France and Germany have thrown their full weight behind the proposal: in a joint letter to the European Commission, their finance ministers, François Baroin and Wolfgang Schauble, said a tax would guarantee a level playing field worldwide and ensure significant revenue-raising potential. But the two countries' efforts to drum up wider support have run into tough international opposition – not only from the United States and the UK, which has threatened to use its veto under the Lisbon Treaty, but also Canada, Australia, Russia and India.

The Commission – not originally an ardent backer of an FTT – claims that 65 per cent of European citizens support the proposal and that the tax will bring in 57 billion euros annually without adversely affecting the financial industry, which it says is undertaxed. Under the directive, stock and bond trades would be taxed at 0.1 per cent and derivatives at 0.01 per cent. The tax would apply to all trading on regulated and non-regulated markets. At first glance the plan seems benign, simple to apply and easy to defend. But in fact it raises plenty of questions, both theoretical and practical.

The first big question is the very purpose of an FTT. Is the aim to stem speculation, raise additional budget revenue or make the financial sphere contribute to solving the crisis? Opponents say the tax would actually increase volatility, reduce liquidity and lead to higher unemployment. Arguments over taxing financial transactions are nothing new. The idea of an FTT has been around for decades. And it is not a European invention. In the 1970s James Tobin, a US economist and Nobel Prizewinner, mooted a tax on foreign exchange transactions to reduce speculation in the international currency markets. In 1989 another American economist, Larry Summers, who went on to serve as Treasury Secretary under President Bill Clinton, argued for a "securities transaction tax" to curb speculation-driven inefficiency, reduce the diversion of resources into the financial sector and lengthen the horizons of corporate managers. And in the 1990s the anti-globalisation movement, notably the Attac association, founded in France, called for a "Tobin tax" to counter the excesses of finance (though Tobin himself disavowed Attac). In the UK, the supporters of an FTT call it the Robin Hood Tax and have mounted a campaign backed by charities, green groups, trade unions, celebrities, religious leaders and politicians. The movement calls itself "a force to be reckoned with".

Divisive issue

The draft EU directive puts forward three reasons for an FTT: to ensure that financial institutions contribute to the cost of fiscal consolidation, create disincentives for transaction that do not enhance the efficiency of financial markets, and strengthen the single market by harmonising the existing system. An estimated 10 of the 27 EU member states already have some form of tax, although the mechanisms vary and are not actually comparable to the FTT in practice. The UK for example has the Stamp Duty Reserve Tax, introduced in 1986, which applies to a narrower scope of trades than does the EU's proposal. The pro-Robin Hood Tax camp claim that Britain already has transaction tax that works. Critics of the FTT proposal, who outnumber its supporters, insist that the tax is not only inefficient but also dangerous. Some point to Sweden's ill-starred experiment with a securities tax in the 1980s, which led to a steep drop in trading and a rise in government borrowing costs.

Whatever the pros and cons, the issue is certainly divisive. In a recent article George Osborne said that Europe should not be creating new burdens and pointed to the Commission's admission that the FTT would cost hundreds of thousands of jobs. And tempers flared when a senior German politician, Volker Kauder, publicly accused the UK of being selfish, saying that even though the country was not a member of the single currency, it still had a responsibility for the success of Europe.

Nevertheless, Europe seems to be moving closer to an FTT. This raises two major concerns for the financial industry, summed up by Marc Touati, head of economic research at Assya Compagnie Financière. "The big problem is feasibility. If only a handful of countries introduce the tax, we will be faced with a competitive imbalance. Even if the aim is to combat speculation, a complex and costly system of oversight will be needed to distinguish between purely speculative transactions and those that are economically useful. And assuming that hurdle is are overcome, data collection and supervision mechanisms will also be needed, and they too will be costly. If we're going to regulate finance, then surely it would be better to beef up the existing regulatory framework". That concern is already materialising. Failure to reach an agreement at the G20 summit, which merely acknowledged "initiatives in some of our countries to tax the financial sector for various purposes", means that Europe will have to go it alone. Even so, despite the assurance of politicians such as Wolfgang Schauble, the FTT is unlikely to be adopted by all 27 member states, given Britain's hostility to the plan – the notorious "bullet aimed at the heart of London". There is even a lack of consensus within the euro zone. Aside from France and Germany, which are in the driving seat, only Belgium, Spain, Portugal and Finland are openly in favour.

Threat to competition

As a result, the riskiest of all scenarios is shaping up, namely a decision taken by a small number of countries that could affect their markets and drive investors away. Critics stress that the proposal tabled by France and Germany could skew the level global playing-field. Under their plan, the burden of the FTT would be shared equally between counterparties resident in the EU, but if one of the parties to a trade is outside the Union, then the EU counterparty would stump up for the whole amount. Moreover, tax experts stress that the yield would fall short of the Commission's 57 billion euro annual revenue target. The narrower the territorial scope, the smaller the tax base.

Stéphane Deo, Head of European Economic Research at UBS explains, “The FTT’s supporters say that one of its purposes is to quell volatility. But if investors are deterred, liquidity will decline and that, in turn, will push up volatility! A side-effect would be to reduce the number of potentially taxable trades. It’s a classic example of the crowding-out effect: as soon as you impose a tax, you automatically shrink its base by driving investors away”. That is why France and Germany are moving towards a system of national FTTs with the broadest possible territorial scope. In this way, non-FTT countries will be encouraged to join the system and recoup via a double tax treaty the proceeds of the tax, which is levied on their own nationals but collected by another country.

The other major concern for the financial industry is that the FTT could have unintended consequences for some products or activities. Although the European proposal for a 0.1 per cent levy seems small, and hence totally reasonable in view of the trading volumes concerned, in practice it will affect different financial activities in very different ways. If the project goes ahead as planned, the politicians will have to set not one rate but several, depending on the type of product. UBS’s Déo says, “The tool has been poorly designed and could have unwanted consequences. A tax is supposed to create as few distortions as possible. But with the FTT, transaction costs would rise by at least 100 per cent, and much more in certain cases”.

Some commentators in Britain and the United States believe that their financial sectors stand to benefit as activities migrate from FTT countries. But not everyone in the Anglo-American world is totally hostile to taxing financial transactions. Prominent figures ranging from Joseph Stiglitz and Adair Turner to Bill Gates and Warren Buffet have all expressed support for some kind of tax, be it Tobin, Robin Hood or FTT (though, as sceptics point out, so have Fidel Castro and Hugo Chavez). But the main problems – aside from political posturing – are to determine the scope and rate of the tax (all transactions, equity and bond trades only but at the same rate?), its purpose (to curb speculation, meet the cost of crisis management or finance government spending?) and, above all, its geographical reach. At the Cannes summit, Nicolas Sarkozy hinted that he would introduce an FTT in 2012, whereas Barack Obama came out firmly against it. Just recently, David Cameron refused to back a tax, and Angela Merkel said she would not take his “no” for an answer. Since an FTT cannot be successful unless it is global, the current proposals will not throw “sand in the wheels of markets”, as James Tobin argued for, so much as fuel on the flames of an already heated argument.

Anthony Bulger

Q&A with…

Pierre de Lauzun, AMAFI Chief Executive

What do you think of the FTT plan in its current shape?

To be effective, a transaction tax would need to be applied on a worldwide basis, and given the outcome of the G20 summit in Cannes, that is a highly unlikely scenario. If the tax is confined to a particular region, the initial consequence would be to drive financial activity away and thus eliminate the jobs and wealth that go along with it. But the key issue is not, as many people think, that “evil” market participants will go elsewhere and carry on making large amounts of money. It is that market efficiency hinges on their ability to match capital or hedging requirements with money seeking a profitable investment. At present, that match is made globally. But why should capital flows head for a region that is taxed if they have an opportunity to avoid it? Economic agents in the taxable region will suffer as the supply of funds dwindles. And the cost of satisfying their requirements will rise inevitably, and by much more so than the tax-induced costs.

What would be the impact of introducing an FTT?

Suppose Europe goes it alone and introduces the tax. It will also have to study the impact on market structure. As the proposal stands, the FTT looks very much like an old-fashioned sales tax. Unlike value added tax, therefore, it would be cumulative. This is an important point because many of the transactions that serve to finance economic activity rely on several other transactions, so the participant that executes them will have to pay tax on each one. Admittedly, this would reduce the number of complex financing deals that may or may not be genuinely useful. But at the same time it would have an adverse effect on all the other transactions that certainly do serve a purpose. A better targeted measure would surely be more effective. That is why I insist on the need for an overarching analysis of market functioning in order to identify any shortcomings and remedy them one by one.

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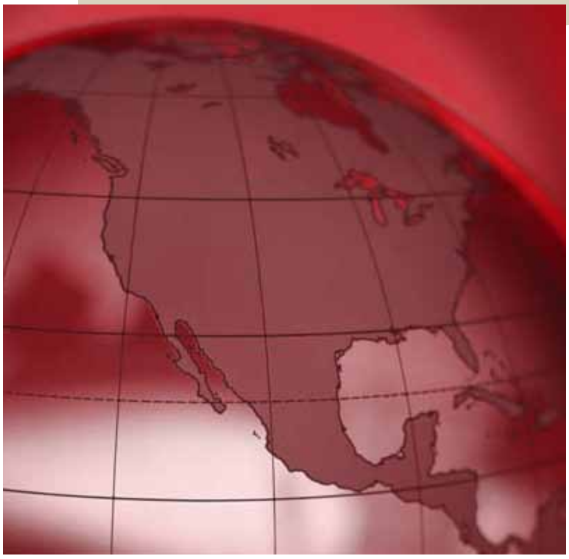
International

Visit to Washington
3 and 4 October 2011

As in previous years AMAFI organised high-level meetings with members of the US Congress (Senate and House of Representatives) and financial authorities (Treasury, Federal Reserve, SEC, CFTC) on behalf of the European Forum of Securities Associations (EFSA). The EFSA delegation, comprising the Association for Financial Markets in Europe (AFME), AMAFI, represented by Chief Executive Pierre de Lauzun and International and European Affairs Director Véronique Donnadieu, and the Swedish Securities Dealers Association (SSDA), discussed a broad range of trans-Atlantic issues with their American talking partners.
The main focus, naturally, was on the financial regulations currently being drafted on both sides of the Atlantic, particularly in the areas of derivatives and prudential rules, especially where major issues of territoriality and coordination between authorities are involved. Also on the agenda were the European crisis and, more generally, the global economic and financial outlook, issues in which Congressmen, Treasury staff and the CFTC President showed a keen interest.

Véronique Donnadieu



Anti-money laundering

The Financial Action Task Force is organising another meeting with the private sector on 5 and 6 December to examine proposed amendments to its recommendations, decided at its plenary committee meeting on 27 and 28 October. ICSA will attend the meeting to stress the issues it has already raised, notably in the response the FATF's September consultation (available on the AMAFI website).

Following the recent publication of its guidelines on beneficial owners, which were broadly targeted, the Autorité de Contrôle Prudentiel is examining the specific case of investment funds (FCPs, SICAV, foreign funds, hedge funds, etc.). AMAFI, via its AML/CTF working group, is taking a particular interest in this issue, since funds often account for a substantial portion of its members' clientele.

Stéphanie Hubert, Marie Thévenot

News

Europe

MiFID review

The European Commission published official proposals on 20 October for the review of the Markets in Financial Instruments Directive (MiFID), in the form of a regulation and a directive. Building on the work on the preliminary draft of the proposals that were circulating in early September, AMAFI continued its analysis through the working groups set up for this purpose. On the subject of market organisation, special attention is being paid at this stage to issues relating to equity markets.

Several priorities for assessment have already been identified:

- Consolidation of post trade data: the lack of ambition evident in the Commission's proposals is worrying;
- Links between different trading systems (regulated markets, multilateral trading facilities, organised trading facilities, systematic internalisers): the proposals need to be clarified in light of the objectives, especially pre-trade transparency;
- Linkage between domestic and European authorities' powers (Commission or ESMA): it is vital to maintain a level playing field that is consistent with the needs of an integrated market.
- The regime for financial institutions based in third countries: aside from a lack of clarity, the proposals fail to give sufficient weight to the principle of reciprocity.

A number of more "technical" issues have also been identified. These include no longer being able to use retail clients' assets as collateral for their positions vis-à-vis clearing houses, the conditions for dealing with products and services relating to high frequency trading, and the possibility for firms to become members of organised markets without having been authorised for order execution or proprietary trading services and hence be regulated as such.

AMAFI will take its analysis further during the coming weeks with a view to preparing draft amendments and presentations for European institutions and the French authorities. The aim also is to make AMAFI's contribution part of a broader review of the market model that Europe should aspire to. This is vitally important to ensure that the Association's views are heard amid the ongoing public debate on these issues.

Véronique Donnadieu, Emmanuel de Fournoux

Competition and market infrastructures

In light of the changes prompted by the review of European directives on the organisation of market and post-trade services, as well as by planned mergers among exchange operators in Europe, AMAFI's Board addressed the issue of competition among market infrastructures *(AMAFI / 11-40).*

Starting from the observation that the policy choice of a European model based on competition among market infrastructures has still not been properly implemented in certain areas, notably clearing for cash and index derivatives markets, AMAFI identified several areas on which the authorities responsible for markets and competition could usefully concentrate:

- For cash clearing, it is vital to make interoperability among infrastructures are reality, by ensuring that:
  - a clearing infrastructure belonging to a silo cannot refuse to handle external transactions under the same terms and conditions it applies to the silo's own trading infrastructure
  - participants in regulated markets and multilateral trading facilities are given a real choice between at least two different clearing infrastructures to handle their business.

- For index derivative clearing, steps should be taken to ensure that index-related operating licences allow market participants that create index derivatives to clear them, under fair terms and conditions, outside the silo that holds the licence.

AMAFI has sent its contribution to the French and European regulators concerned.

Emmanuel de Fournoux

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Europe

Review of the Market Abuse Directive

Alongside proposals for the MiFID review, the European Commission published draft amendments to the Market Abuse Directive, also in the form of a regulation and a directive, whose objective is to harmonise criminal penalties for abuse. The overall ambition of the Commission is to strengthen market integrity.

AMAFI fully endorses that aim but is paying close attention to two crucial aspects.

Make sure the arrangements are unambiguous and transparent so that they will be effective

To meet the aims of the review, the key concepts on which the arrangements are based need to be unambiguous and transparent. This is vital to ensure that the competent authorities and criminal courts are able to exercise their powers properly, especially given the extended scope of criminal law. But it is also vital to underpin the efforts made by financial institutions in particular to monitor and prevent market abuse.

However, since the Commission has sought to address a wide range of market abuse situations, it is relying on concepts that are broadly defined. As a result, its proposals are hard to put into practice and could spark controversy. In particular, the concepts of "behaviour", "attempt" and "relevant information" (included in the definition of inside information) need to be precisely defined.

Do not create the impression of enhanced protection because it will not exist

The proposals imply that all markets will be protected uniformly and exhaustively. But this is highly unlikely. First, all financial instruments would have to be supervised, even though national authorities are struggling to cope with their current scope of supervision. Second, regarding inside information, the waivers proposed by the Commission, especially for mid cap issuers, raise questions about the level of integrity that the markets concerned will be able to guarantee. Last, in some markets, such as the commodity derivatives market, the concept of inside information relies on insufficiently standardised basic information.
Some of the key questions raised by the proposals concern mid cap issuers. The idea that companies not listed on regulated markets should not be saddled with a top-heavy administrative burden is certainly laudable, but it also clashes with the Commission's objective to enhance investor protection and market integrity. Moreover, it raises questions about the scheduled phase-out of accepted market practices, especially liquidity contracts. This practice has been adopted by a growing number of European countries and plays a useful role in the functioning of mid cap markets – and other markets as well. It is therefore a central focus of AMAFI's discussions, both at present and in the months ahead.

Stéphanie Hubert, Sylvie Dariosecq

Automated trading ESMA guidelines

AMAFI responded *(AMAFI / 11-38)* to the ESMA consultation on *Guidelines on systems and controls in a highly automated trading environment for trading platforms, investment firms and competent authorities*. It argued that implementing the guidelines was very important in light of the recent growth in automated trading, provided that regulators reach formal agreement to apply them in a similar way.

More specifically, a detailed analysis showed that some of ESMA's proposals could be implemented forthwith because they raise no particular problems while others need further consideration. The latter category includes proposals that firms should check clients' ability to honour their settlement obligations and that internal control teams should monitor order flows in real time.

Emmanuel de Fournoux

Carbon and energy markets

The AMAFI Commodities closely monitored the EU Regulation on Energy Market Integrity and Transparency (REMIT), adopted by the European Union on 19 October and due to be published shortly.

In carbon markets, the migration of the system based on national registries to a single European registry, scheduled for 1 January 2012, must be closely monitored because of the potential impact on intermediaries. The same applies to protecting the trading and holding of CO_2 certificates. Aside from the important issues of liquidity and confidence, care is needed to ensure that the new system, which hinges on the buyer's "good faith", can be implemented uniformly regardless of the domestic legal environment in which this concept will be used.

Dominique Depras

News

France

Major shareholding notifications

AMAFI was consulted once again, informally and urgently, by the Treasury on a draft reform to the treatment of cash-settled financial instruments. The new plan differs from the proposal tabled by Senator Philippe Marini before the summer since it recommends that cash-settlement instruments be treated as shares only for transparency purposes, not in connection with takeover bids, for which they are specifically ruled out.

AMAFI supports this new plan (AMAFI / 11-35), which features several of its proposals, subject to certain technical modifications. It was introduced as an amendment in the Warsmann Bill on legal simplification and streamlined administrative formalities, which was adopted as-is by the lower house of parliament on first reading and is currently before the upper house. As it stands, the bill is broadly consistent with the principles set forth in the proposal for a directive amending the Transparency Directive.

Sylvie Dariosecq

Public offerings
Advertising materials

Following up on an issue raised by its Corporate Finance Committee, AMAFI submitted proposals to the securities regulator, AMF, on the disclosure of risk factors in advertising materials, such as leaflets, that are published in connection with transactions involving a public offering of shares.

AMAFI proposed including a clear, legible and understandable reference to the risk factors discussed in the prospectus in order to meet the need for proper investor disclosure and satisfy the MiFID requirement that investment risk be presented in a way that is fair, clear and not misleading. Discussions on this issue are now underway with the AMF.

Sylvie Dariosecq, Marie Thévenot

New Members

➚ **Dexia Crédit Local**, a credit institution authorised to provide the main investment services, i.e. order execution for third parties, investment advice and placing of financial instruments with and without a firm commitment basis. The company's senior managers are Jean-Luc Dehaene (Chairman of the Board of Directors) and Alain Clot (CEO).

➚ **Galaxy SAS**, a market infrastructure whose main business is to operate an organised unilateral trading facility on the fixed income market for institutional investors. The company's senior managers are Philippe Buhannic (Chairman) and Jean-Philippe Malé (CEO).

➚ **Joh. Berenberg**, Gossler & Co, a credit institution whose main businesses are trading in transferrable securities for own account and for institutional clients; and wealth management and advice services. The company's senior managers in France are Dalila Farigoule and Christophe Choquart.

➚ **Mirabaud France SA**, an investment firm specialising in discretionary investment management, order reception/transmission, investment advice and custody account keeping for private clients. The company's senior managers are Raphaël Spahr (CEO) and Cécile Troger-Beltran (Deputy CEO).

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www.amafi.fr
Most of them, notably AMAFI's responses to public consultations, are freely available, but some are restricted to members only.

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