INTERNATIONAL COUNCIL of SECURITIES ASSOCIATIONS

October 27, 2011

José Manuel Barroso
President
European Commission
B-1049 Brussels, Belgium

Michel Barnier
European Commissioner for Internal Market and Services
European Commission
B-1049 Brussels, Belgium

Algirdas Šemeta
Commissioner for Taxation and Customs Union, Audit and Anti-fraud
European Commission
B-1049 Brussels, Belgium

Dear Sirs:

We are writing to you on behalf of the members of the International Council of Securities Associations (ICSA), which is the global body for trade associations and SROs that represent and/or regulate firms active in securities markets.[1] ICSA is a global organization and as such generally comments only on global regulatory initiatives. However, based on a broad consensus among ICSA members, we are writing to express our opposition to a possible financial transactions tax (FTT) in Europe.

A number of academic studies have shown that financial transactions taxes distort markets and thereby impede their efficiency.[2] A broad based FTT in Europe would most likely result in a reduction in trading volumes in various markets, reducing liquidity in those markets and widening bid-offer spreads, thus increasing the cost of capital for businesses and reducing prices. Higher capital costs, in turn, would adversely affect investment and quite possibly contribute to a slowdown in economic growth. All investors, including pension funds and individuals saving for retirement, would also be faced with higher costs since they would bear a significant part of the taxes directly and at the same time would be adversely impacted by the reduction in securities

[1] ICSA's members come from a broad range of jurisdictions and represent and/or regulate firms active in all of the major developed financial markets as well as a number of advanced emerging market economies. ICSA's objectives are: (1) to encourage the sound growth of the international securities markets by promoting harmonization in the procedures and regulation of those markets; and (2) to promote mutual understanding and the exchange of information among ICSA members. More information about ICSA can be found at: www.icsa.bz

[2] A recent review of the literature and overview of the debate about FTTs can be found in Thornton Matheson, 2011, *Taxing Financial Transactions: Issues and Evidence*, IMF Working Paper/11/54 (Washington, DC).

prices. This result would be completely counter to the efforts by the Commission and its members to ensure adequate, sustainable and safe pensions for their citizens.

Further adding to the damage that a FTT would inflict on capital markets, unilateral imposition of a FTT by the EU would most likely encourage capital flows out of European financial markets to markets without such a tax. Already a large number of European financial centers have seen their competitiveness diminish relative to other financial centers and the imposition of a FTT would only further that trend.[3] In effect, a financial transaction tax would negatively impact financial markets, financial firms, institutional and private investors, issuers, retirees and, ultimately, the public at large.

We are particularly concerned about the impact of a FTT at the current time when economic growth remains stagnant in many countries around the world. This is a critical issue in the EU, which is already experiencing declining economic growth along with a sovereign debt crisis and loss of confidence in the banking sector. Since businesses and investors will bear the costs of a FTT, there will be proportionately less funds available for investment and job creation, to the detriment of Europe's growth prospects.[4] In addition to slower economic growth, governments may find that a FTT negatively impacts their ability to manage their own debts, which would be a particular concern in light of the current sovereign debt crisis. The FTT could have this effect since the tax could lead to a decrease in the trading volume of and liquidity for government bonds, notwithstanding the envisaged exclusion of primary markets transactions from the FTT's scope of application. The reduction of liquidity in government bond markets would, in turn, reduce investors' appetite for those securities, with a consequent increase in the premium that would be demanded.

In addition to the objective of raising revenues, we are aware that the proposed FTT also aims to limit "undesirable market behavior" and thereby stabilize financial markets. Specifically, according to the Commission's summary impact analysis, the FTT would address particular risks posed by automatic trading and might, "…reduce excessive risk-taking to the extent that short-term trading and highly leveraged derivative trading creates systemic risks." In this context, we refer to the analysis carried out last year by the IMF regarding the potential impact of financial transactions taxes on financial sector stability. In that study the IMF found that a FTT would not be a useful tool for stabilizing financial markets since it would not be focused on the core sources of financial instability.[5] In its more recent work on the issue, published earlier this year, the IMF

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3. See *The Global Financial Centres Index* (September 2011).

4 The Impact Analysis published by the European Commission shows that the FTT could reduce long run GDP by up to 1.76% (or 0.53% once mitigating factors are taken into consideration). However, the actual cost to the economy may exceed that estimate both because the analysis contained in the Impact Assessment is based on a highly restrictive theoretical model (which assumes, for example, a closed economy) and because the estimate does not take into account the costs resulting from the loss of the derivatives markets, which will increase hedging costs for pension funds and firms.

5 Specifically the IMF's noted that FTTs are not useful for stabilizing financial markets since they, "...would not target any of the key attributes—institution size, interconnectedness, and substitutability—that give rise to systemic risk". See Stijn Claessens, Michael Keen, Ceyla Pazarbasioglu, 2010, *Financial Sector Taxation: The IMF's Report to the G20 and Background Materials* (Washington, D.C.), pg. 17.

explicitly noted that financial transactions taxes were inefficient instruments for curbing financial market excesses.[6]

The Commission's summary impact analysis states that the recent financial crisis, "…resulted from the complex interaction of market failures, global financial and monetary imbalances, inappropriate regulation, weak supervision and poor macro-prudential oversight." We agree with that assessment and for that reason ICSA members support well designed, balanced and proportionate financial sector reforms as the appropriate response to the financial crisis. A FTT, no matter how well it is designed, could not substantially mitigate the factors which the Commission's own impact analysis highlights as being the most significant in bringing about the financial crisis. Instead of increasing financial stability, a FTT will likely contribute to lower rates of economic growth in Europe and reduced international competitiveness of Europe's financial markets and firms.

Please do not hesitate to contact us at your earliest convenience regarding the issues discussed in this letter.

Best regards,

Kun Ho Hwang, Chairman
International Council of
Securities Associations (ICSA)

Duncan Fairweather, Chairman
ICSA Standing Committee on
Regulatory Affairs

6 Matheson, op. cit., pg. 26.