DEUTSCHE BÖRSE GROUP

Public Hearing

at the finance committee of the German Bundestag

Statement of

Deutsche Börse Group

on the proposal for a Council Directive on a common system of financial transaction tax and amending Directive 2008/7/EC

Berlin, November 2011

I. Background and Overall Position of Deutsche Börse Group (DBG)

In light of the financial market crisis, DBG is able to understand the political motivation to use the financial sector in an appropriate way for financing public households. It is important to DBG as a provider of highly regulated market infrastructures with reliability and integrity that every regulatory measure – also taxation related – serves to strengthen the transparency, integrity and stability of the markets, in view of experience gained from the financial crisis. Thereby, it is also important that the measures do not lead to competitive distortions and regulatory arbitrage or movement into opaque niches.

We have taken note of the recently published proposal by the EU Commission for a directive to introduce a financial transaction tax (FTT) in Europe by 2014. However, we are not convinced that a financial transaction tax is the appropriate instrument to effectively support the goal of increasing safety and integrity on the financial markets. Such a tax creates incentives to move even more to intransparent and unregulated markets and products. An FTT limited to the EU would be a gift to the unregulated and non-cooperating financial centres of the world, thereby reducing revenue prospects and the effectiveness of supervision. Moreover, the proposal fails to address the growth of leverage, systemic risks, or the moral hazard risks arising from 'too-big-to-fail' or 'too-systemic-to-fail' institutions.

Despite an FTT targeting secondary activity it can cause a knock on effect on the primary markets. By raising transaction costs and lowering liquidity in secondary markets trading, this can make it less attractive for investors to subscribe to new primary equity issuance. This therefore would significantly increase costs of capital for corporate and SME end users in the EU Member States and establish a barrier to accessing the financial markets. Furthermore it would restrict liquidity (and therefore increase volatility) in those markets.[1]

Besides the negative effects on the European economies DBG recommends that Europe's policy-makers also closely consider the very real impact of the FTT on Europe's pensioners, savers and households. Empirical studies have shown that with an introduction of FTTs the attractiveness (return expectations, cost efficiency) of assets such as equities, bonds and funds will decrease[2]. Declining returns will affect institutional as well as retail (fund) investors[3], e.g. for private retirement arrangements. At the end the FTT does not make those market players that caused the crisis contribute toward the cost of dealing with it.

In addition, the FTT increases transaction costs leading to a reduction in trading volumes. An IMF working paper looking at FTTs[4] highlights the elasticity of trading volume with respective to transaction costs. Certain trades become unprofitable altogether or trading volume shifts to financial centers without an FTT (e.g. US, Singapore). As a consequence, the liquidity on European markets would significantly decrease causing raised cost of capital for corporate end users and investors located in the EU. Moreover, reduced trading volumes and liquidity have a negative impact on the institutions' means of effectively hedging risk[5] – which is true for financial institutions and

[1] See ISDA Comments on EC's Proposal for a Financial Transaction Tax.
[2] See Commission Staff Working Paper, Executive Summary of the Impact Assessment, p. 11.
[3] See Barclays Capital, Equity Research, 4 October 2011, p.3.
[4] See IMF Working Paper WP/11/54 by Thornton Mathesno.
[5] See Barclays Capital, Equity Research, 4 October 2011, p.3.

corporates as well. The derivatives industry provides important risk management tools helping to achieve growth in the economy. It serves a variety of large, medium and small corporations and entities, which use derivatives products to manage interest rate, currency, credit and counterparty risks. GDB is concerned that the FTT will ultimately increase the costs of hedging those risks. We believe that managing such risks is essential for the long-term economic growth and recovery of European economies[6].

DBG is also concerned that the FTT, at the rates proposed, would drive up the costs of liquidity management to uneconomic levels by imposing additional costs on repo[7] transactions[8]. The interbank financing activity is to a very great extent associated with the management of bank liquidity management. EU banks have a relatively high reliance on counterparty safety and consequently access to wholesale funding is critical to the safety and sustainability of the sector. In recent years, money market activity has become increasingly collateralised as the authorities and participants alike have tried to increase safety and the tax has the potential to reverse that trend. Repo transactions, both Triparty and Bilateral, are tools essential to the management of banks' funding bases. Whilst DBG appreciates that some reduction in the size of the sector's balance sheet may be a policy objective, reliance on interbank financing will remain characteristic of the sector for the foreseeable future.

DBG believes that the introduction of an FTT is not in line with the political purpose of complementing regulatory measures aimed at avoiding future crisis as such a tax cannot prevent any speculation or speculation bubbles.

Overall DBG is concerned of the planned introduction of a FTT as it would have the above mentioned consequences:

1. Creation of incentives for certain market participants to move even more business to intransparent and unregulated markets and products
2. Increase of costs of raising of capital for corporate and SME end users in Member States
3. Establishment of an access barrier to financial markets for SMEs
4. Reduction of attractiveness of regulated markets
5. Significant reduction of the liquidity and efficiency of European financial markets
6. No prevention of speculation or speculation bubbles but through further fragmentation rather enhanced.

[6] See ISDA Comments on EC's Proposal for a Financial Transaction Tax.

[7] In a repurchase, or "repo", transaction, an investor can borrow cash for a short period from another party, using securities as collateral for the loan.

[8] Clearstream Banking Luxembourg calculates that the average notional value of repo transactions settled in its books stands at around EUR 2.5 Mln, imposing a cost of EUR 5,000 per deal where both counterparties are EU residents against an existing execution cost of approximately EUR 1,00.

II. Relevant Aspects of the EC Proposal require further clarification

Given the complexity of an introduction of an FTT and the far reaching implications for the European economies and financial markets certain crucial aspects of the proposal need further clarification before a comprehensive assessment of the consequences is possible.

As described in the text above it needs to be considered that the introduction of a FTT will likely results in the relocation of businesses outside of the EU. Although the residence principle might avoid the relocation of larger and complex organisations, it would likely be the case for flexible business as well as for traditional 'long only' fund management companies located in the EU. EU-based Investment Funds Companies (IFC) will have to pay the FTT for all transactions related to its Assets Under Management. Non-EU based IFCs will not be subject to the tax. The outcome: The performance achieved by the non-EU IFC will be better[9] than the performance delivered by the EU IFC with significantly increasing costs. Everything else being equal, a rational investor will prefer to invest in funds offered by non-EU IFCs.[10] This is regardless of the fact that an EU investor would have to pay the FTT for transactions in the fund shares, which applies in both cases mentioned above. In our view it is not indicated in the proposal how the European policy makers want to prevent this weakening of European economies. Moreover, do European policy makers really intend a relocation of businesses into markets which are less regulated and transparent and which are out of reach for European supervisors?

Due to our understanding the released proposal is also unclear on how and by whom the FTT would be collected in principle. Specifically with regard to in which way the collection could be carried out, if a financial institution, which is established in a non-EU territory, has to pay the tax. The problem would be intensified, when it comes to intransparent OTC transactions.

Following the aspect of tax collection, the proposal is vague about the question if both parties of a taxable transaction each have to pay the full amount of the tax or if it will be split in two parts.

A further aspect of the proposal that remains unclear is the mentioned scenario, if one of the parties is not paying, so the other party could be hold jointly and severally liable for the payment of the FTT. This again raises the problem, what would be the concrete legal implementation of the payment, if the non-paying party is outside EU jurisdiction and thereby not within the reach of legal persecution through the Member State authorities. And if a CCP is involved in such a transaction, the situation could get even more complicated, because the non-paying party outside EU jurisdiction is anonymous to its counterparty in the whole process chain. Moreover there is no information about the important question, if the liability in such a case also applies to CCPs or if they should revoke the anonymity of the non-paying party towards the regulatory authorities.

The question above about the CCP leads to the lack of clarity with regard to the important role of CCPs, CSDs and ICSDs in general. As the proposal states, they are out of the scope, where exercising their functions. But the text does not specify if an involved CCP or CSD/ICSD is really neutral respecting all possible scenarios. In our understanding, it also does not matter, where the CCP or CSD/ICSD itself is established to classify a transaction taxable. The proposal needs to clarify, if a CCP

[9] The difference in performance will equal the amount of the FTT paid for each transaction in its assets.
[10] Please note that funds offered by non-EU IFCs are easily available within the EU today due to their strong presence and existing distribution channels.

or CSD/ICSD does not generate any legal consequences for the taxation of a transaction. The political purpose of regulatory measures during the last years aimed at avoiding future crisis especially through shifting business from the intransparent OTC segment to organized markets. But there would be a major shift of business to unregulated markets and products, if the European establishment of an involved CCP or CSD/ICSD infects trades between non-EU parties for a tax obligation. Hence the neutrality of CCPs, CSDs or ICSDs is a fundamental issue for the whole market structure.

Based on that aspect of the proposal, it is also not apparent, if an involved clearing member, who is able to settle obligations of clients (a so called General Clearing Member), would be charged or not when trading for the account of another financial institution. To tax every "step" in a transaction chain involving a CCP and its members would only counteract the political efforts to broaden trading on regulated markets.

Seen from the angle of the many global trading activities, another issue appears, if there is a transaction between a non-EU financial institution and a non-EU branch of a financial institution, which is established in a Member State. Now the proposal is not clear on how the burden of proof can be lifted, that the transaction is not in connection with the European business of the parent company.

In our view it is one of the key problems of the proposal, that it cannot be assessed how EU law could be applied to non-EU jurisdictions in the scenarios mentioned without major legal and operational issues.

III. Recommended amendments for the EC Proposal (non-exhaustive)

Given our concerns about the introduction of an FTT, we like to urge the regulatory authorities to consider the following amendments for the EC proposal:

- The area of applicability needs to be global or at least as wide as possible. In our view the FTT has at least to apply to the European Union with all 27 Member States.

- Involved CCP, CSD and ICSD-constructions should be neutral in every legal aspect of a transaction to avoid further relocation of business to unregulated markets and thereby weaken market infrastructure as well as enabling risk spreading of those constructions.

- General Clearing Members when acting as such should not be charged with the tax.

- The proposal of holding a party jointly and severally liable for the payment of the tax should not be implemented in the Council Directive.

IV. Concluding remarks

DBG is able to understand the fundamental will of political decision makers and regulators to involve the financial sector in financing public budgets in an adequate manner. As expressed above, we do not consider the FTT as the appropriate instrument. During the past years different regulatory measures were targeted on improving the safety and integrity of European financial markets. In contrast to the intransparent off-exchange market, especially regulated markets should be strengthened. These efforts towards stability and transparency could be frustrated if the present EU-Commission proposal was implemented. Especially regulated and supervised market structures are not able to bypass the FTT by flexible organisation possibilities. It is therefore certainly not the purpose of regulators to cause the opposite effect on a national or European level, for instance because of the explained CCP/CSD/ICSD-problem and the designated risk of a transfer of trading activity to intransparent and not regulated areas and therefore a weakening of the European market infrastructure. In order to avoid future crises, but also for Europe to remain a competitive economic area, a regulation oriented towards efficiency and stability is necessary.

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If there are any further questions, please do not hesitate to contact us.

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