Position paper

Insurance Europe reiterates key concerns about the financial transaction tax

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General comments

Given the renewed momentum of negotiations over the introduction of a financial transaction tax (FTT) in 11 EU member states, Insurance Europe would like to take the opportunity to reiterate a number of concerns relating to this project.

Insurance Europe remains convinced that an FTT would have a negative impact on the real economy. FTTs increase costs for users of financial markets, be they governments, pension funds, insurers or other corporates. This will inevitably have a negative impact on end-users of financial markets: consumers of financial products such as insurance policyholders or pension-fund beneficiaries.

In addition, the introduction of an FTT in the EU could have a series of unintended consequences (eg the reduced market liquidity of EU shares, the increased cost of capital and the relocation of trading activities), with the resulting unfavourable outcomes in terms of economic growth. One of the stated objectives of the FTT is to discourage speculative transactions, thereby reducing short-termism and encouraging sustainable, long-term growth. If this were the case, the benefits of an FTT might indeed outweigh the costs. However, the FTT as it is currently envisaged is not targeted exclusively at transactions that can be considered speculative but will rather end up being levied on many transactions with a long-term horizon as well.

Insurance Europe also believes that the introduction of an FTT in a limited number of EU countries would disrupt rather than strengthen the EU single market, as it would increase the differences between FTT markets and non-FTT markets. The entry into force of the FTT would thus lead to a competitive disadvantage for companies from jurisdictions that are subject to the FTT. Consequently, the FTT would constitute a significant obstacle to achieving integrated capital markets in the EU, which is the primary aim of the European Commission's current capital markets union initiative.

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For all these reasons, Insurance Europe is opposed to the introduction of an FTT. Nevertheless, if participating member states decide to move ahead with this initiative, Insurance Europe would like to highlight some of what it considers the most negative effects of an FTT and to propose possible ways to work around them. A particular emphasis will be placed on the detrimental effects that the FTT would have on pension provision in Europe.

Negative impact on pension provision

An FTT, as it is currently envisaged, would have a negative effect on pension provision in Europe. In the insurance sector, the costs of the FTT will push up insurers' expenses and will inevitably reduce investment returns for consumers. These consumers include policyholders who have signed contracts designed to provide long-term retirement income and protection against an unforeseen life event.

It is Insurance Europe's strong belief that the tax system should not discourage long-term savings, especially those associated with risk coverage. Doing so would be particularly inappropriate at a time when efforts are being made to encourage financial protection for old age. Imposing an additional tax burden on retirement and other long-term insurance savings products is inconsistent with the objective put forward by the Commission and the efforts of member states to increase the role of complementary retirement savings plans in pension systems in response to demographic changes.

Indeed, member states are routinely encouraged to increase the share of funded pension schemes, notably pillar II (funded occupational pension schemes) and pillar III (individual voluntary contracts normally between individuals and insurance companies and incentivised by governments usually via tax breaks). In several member states, life insurance companies account for a significant share of pillar II and pillar III pension schemes; a share of up to 90% in some countries for the latter. The retirement products provided by insurance companies are thus indispensable for meeting the challenges presented by ageing populations in every member state.

Therefore, in order to ensure that Europe's pensioners and long-term investors are not adversely affected, it is essential that any arrangements specifically targeted at pension funds (ie Institutions for Occupational Retirement Provision or IORPs) under the FTT regime are applied to the entire market for retirement products, regardless of their legal form. In Insurance Europe's view, this should be based on the principle of "substance over form", whereby all financial institutions that provide occupational pension products should be regulated not on the basis of the legal vehicle through which the products are sold, but rather according to the benefits those products provide to beneficiaries.

However, Insurance Europe would point out that this equivalence objective would **not** be effectively achieved by using either of the following:

- The definition of an IORP as given by Article 6 of the IORP Directive, because life insurers do not fall within the scope of this definition.

- Article 2 - 10 point (c) of the European Market Infrastructure Regulation (EMIR), as this requires that all assets and liabilities corresponding to the pensions business be ring-fenced, managed and organised separately from the other activities of the life insurance undertaking, which is not a reality of market practice. Even if life insurance is always managed separately from non-life insurance, almost no insurer finds it feasible to have an additional clear delimitation between life insurance pension products and other life insurance products (eg those with death benefits) as combined management is beneficial from a risk, diversification and capital point of view.

What constitutes a "pension product" varies significantly from country to country. Therefore, since it is neither possible to provide a comprehensive definition of a "pension product" at EU level nor to effectively define an exemption that would apply to all pension products regardless of their legal form in the text of the FTT, it is

Insurance Europe's opinion that it would be more effective to leave the definition of "pension products" which should fall outside the scope of the FTT to national authorities. Otherwise, it would be essential to apply a broad definition of a "pension product" at EU level so as to successfully exempt all national varieties of "pension products", such as in Article 2(2) point e) - g) of the PRIIPs Regulation.

Additional considerations

- **Transactions with bonds on the secondary market should be excluded from the scope of the FTT.** European insurers are significant investors in both corporate and government bonds. The main rationale behind insurers' choice of bonds is the need to be invested in assets that can match their liabilities' profile in terms of maturity, liquidity and return. Insurance companies acquire bonds via both the primary and the secondary markets and the availability of these assets is vital for good insurance asset/liability management. Therefore, investing in such instruments should not be disincentivised by the FTT. In addition, imposing the FTT on the secondary bond market would affect the attractiveness of medium- and long-term bonds. As a consequence, the cost of finance for both corporates and governments could become significantly higher, and the tax relief on such costs greater.

- **Cascading effects (multiple taxation of a single transaction) should be avoided.** If the FTT is imposed on every single transaction, this would lead to a "cascading effect" whereby a single transaction generates multiple instances of the tax. This cascading effect makes the effective rate of the FTT on securities much higher than the headline rate (whatever that may be). The reason is that the chain of trading and clearing that lies behind most securities transactions usually involves various stages of trading and settling. A purchase of securities on a stock exchange, for example, routinely involves sale and purchase by a number of parties, including brokers, clearing members and the central counterparty, all being parts of the clearing system. Often, this is imposed by regulation, such as EMIR, which introduces mandatory clearing through authorised central counterparties.

- **Intra-group transactions, including reinsurance, should be excluded from the scope of the FTT.** An FTT on intra-group transactions would seriously hamper the business activities of insurers. Insurers and reinsurers commonly need to balance their risk positions and those movements are sometimes of a substantial size within a financial group. In some cases, these movements are encouraged by regulators as precautionary measures, such as in the context of the Solvency II legislation. Insurance Europe sees no demonstrable reason for imposing a tax on such movements within a group. Similarly, applying the FTT to reinsurance entities would seriously hamper the business needs of insurers. Insurers use reinsurance to balance their risk positions, especially to protect against natural and man-made catastrophes, which, without reinsurance protection, could threaten the viability of the insurer. Increasingly, insurers use reinsurance to protect against longevity risk on their pension provision business. The FTT deters such protection, again increasing rather than decreasing risk in the European economy. Reinsurance premiums may also be paid in the form of financial instruments, often because those assets hedge the underlying insurance risk. Applying an FTT to such transfers would impede commercial risk diversification and protection.

- **Derivatives used for risk mitigation should not incur an FTT charge.** Derivative instruments are routinely used in insurance to match liabilities and assets. In order to maintain a sustainable derivatives market, the taxation of derivatives should be reconsidered. In particular, by taxing the notional value of derivative contracts, the FTT would have a considerable impact on insurers' ability to ensure efficient asset management and control of risk. Solvency II incentivises good risk management and recognises that derivatives can be part of an insurer's risk-mitigation techniques. The risk-mitigation effect of derivatives is reflected in the solvency capital requirements, and Solvency II allows insurers to use derivatives only if they contribute to a reduction of risks or facilitate efficient portfolio management. Therefore, Insurance Europe strongly believes derivatives should not incur an FTT charge.

- **Extra-territoriality issues should be clearly addressed.** Complying with the proposed FTT would be especially burdensome for parties based in non-participating member states. Those financial institutions would only know if they were liable to pay the tax and at which rate if they know their counterparty's residence. However, the current trading systems are not adapted to provide that kind of information today, as trading platforms are based on anonymity. Moreover, individual transactions are not matched one-to-one but rather processed in larger batches. In addition to a high risk of fragmentation of the internal market, the administrative burden resulting from adapting all existing systems would be significant, especially for the financial institutions established outside the FTT area that do not trade regularly with the FTT area.