THE ASSOCIATION OF GLOBAL CUSTODIANS

BNY MELLON
BROWN BROTHERS HARRIMAN
CITIBANK, N.A.
DEUTSCHE BANK
HSBC SECURITIES SERVICES
J.P. MORGAN
NORTHERN TRUST
RBC INVESTOR SERVICES
SKANDINAVISKA ENSKILDA BANKEN
STANDARD CHARTERED BANK
STATE STREET BANK AND TRUST COMPANY

COUNSEL AND SECRETARIAT TO THE ASSOCIATION:

BAKER & MCKENZIE LLP

EUROPE
ATT: ARUN SRIVASTAVA
100 NEW BRIDGE STREET
LONDON EC4V 6JA, ENGLAND
INT'L TEL: 44 20 7919 1000

GLOBAL
ATT: ROBIN TRUESDALE
815 CONNECTICUT AVENUE, N.W.
WASHINGTON, D.C. 20006
TEL: 202 452 7000
FAX: 202 452 7074

WWW.THEAGC.COM

9 January 2013

Commissioner Algirdas Šemeta
European Commission
200 rue de la Loi
1049 Brussels
BELGIUM

Re: <u>Financial Transaction Tax</u>

Dear Commissioner,

We write on behalf of the members of the Association of Global Custodians ("AGC" or "Association")[1] to provide you with their views regarding certain practical aspects of the proposal to introduce a financial transaction tax ("FTT") in a number of European Union ("EU") Member States pursuant to the "Enhanced Cooperation Procedure". By submitting these comments, the Association does not endorse in any way the proposal currently under consideration to introduce such a tax. Indeed, members of the Association have strong reservations about the imposition of such a tax and concerns about its potential impact.

[1] The Association is an informal group of 11 member banks that provide securities safekeeping and asset-serving functions to cross-border institutional investors worldwide. Members provide custody-related services to most types of institutional investors, including investment funds, pension funds, and insurance companies. Members' clients include European-based funds and investors, and members play a substantial role in European markets. Association members are listed on the letterhead above.

The purpose of this letter is to provide the Association members' views and recommendations with respect to specific design features and practical implications of an FTT, in the hope that the Commission will consider comments before finalizing a substantive FTT proposal. In preparing these comments, members have taken into account the Commission's 2011 draft Directive for an EU-wide FTT, but have also drawn on their significant experience with the implementation of other transaction-based taxes and charges.

The Association has a deep interest in the processes enabling securities trading, payment and settlement, and custody in securities markets around the globe. Association members hold in excess of EURO 60 trillion in assets globally, with a significant portion of that in the EU. In their role as providers of global custody services, Association members have substantial involvement in the execution and settlement of securities trading on behalf of customers, and accordingly have significant experience with and insight into the manner in which financial transaction taxes can affect such processes. Indeed, with the introduction of transaction taxes in a number of jurisdictions already, Association members have direct experience with the significant practical challenges that can result from various design features of such taxes.

If a harmonized EU FTT is implemented across a number of adopting Member States it will be essential to ensure commonality of the scope of the tax. The adopting Member States should not underestimate the vital need to co-ordinate the many operational aspects of any EU FTT. This would include identification of the party which bears the economic cost of the tax or, in multiple party scenarios, the party which is expected to withhold, report and deliver the EU FTT, introduction of standardized reporting time frames and reporting forms, of standardized methods of calculating the tax payable and a standardized penalty and audit regime. These are a small selection of the significant areas that would require close coordination at a detailed level. If implementation proceeds, sufficient time must be allowed for this coordination to occur and all relevant stakeholders should be consulted.

The framework for the application of the EU FTT is likely to be quite complex for Global Custodians and their clients in that the identification of the withholding and reporting entity is likely to depend on how the transaction is executed, where the transaction is executed, the legal nature of the transaction (e.g., a securities transaction over a settlement system versus over the counter (OTC)), and the number of parties involved in the chain of the transaction. Ensuring there is consistency in implementation will also be critical to ensuring the EU FTT is capable of meeting its revenue requirements.

Our comments at this stage are focused on the following areas of primary concern:

I. The importance of clarity regarding the party responsible for the deduction and remittance of the tax;

II. The importance of clarity regarding the scope and applicability of the tax;
III. The importance of a clear, consistent, and simple calculation, reporting and payment mechanism;
IV. The importance of clear guidance regarding implementation, including timelines, language, consideration of transaction flows, and sufficient use of defined terms.
V. Members' observations and experiences in the case of other transaction-based taxes.

We also provide a list of "Key FTT Questions" in an addendum to this letter. We believe that any FTT that is implemented would need to address these questions definitively.

I. Responsible Party

In order to implement a transaction-based tax, there must be absolute clarity regarding the definition and identification of the party responsible for any required withholding, remittance, and reporting. It is especially vital to clearly distinguish between the "accountable" party and the "liable" party. In the UK, the custodian is accountable for reporting and the end investor is ultimately liable for the tax as it is ultimately their investment decision to buy the stock.[2] While we understand the alternative view that the European Commission's proposed approach is to make banks liable to pay FTT, we stress that clarity around the implementation points that we identify in this letter must be addressed in order to facilitate a real possibility that such a tax can be workable in practice. We are therefore obliged to put forward what we believe is best practice based on the collective experience of custodians in facilitating payment of transaction taxes.

Optimally, such a transaction-based tax would be deemed payable on the inception of an in-scope transaction, such as to render questions relating to responsibilities of intermediaries in the path of the transaction settlement process moot. In any model where this might not be the case, rules and guidance must clearly identify the roles and responsibilities of all parties involved in the transaction lifecycle, and consider the extent of the scope of the tax in light of the way in which transactions are undertaken globally.

Additionally, in any case where rules place a responsible party in a position to require or rely upon information from a 3rd party (including another financial intermediary or party to the in-scope transaction), rules and guidance should clearly define the information and/or certifications required to determine acceptability of such information. This ensures that the responsible party knows whether or not, and to what extent, it can rely on information provided to it (whether by its client, a market

[2] We stress, however, that the "UK model" relies in large part on a key functionality provided by the UK Central Securities Depository (CREST). Similar implementation in other Member States may require systems enhancement if manual processing is to be avoided: it is not envisioned that the new European settlement platform (T2S) will include functionality to process identification, collection and payment of FTT.

counterparty, a clearing or settlement system, or tax authority)and what evidence or other data the accountable party is required to retain from an audit perspective.

As an illustration of this point, implementation rules related to the French FTT state that the investor must provide its custodian with sufficient information to declare and pay FTT where applicable on transactions that do not involve a broker. Unfortunately, rules do not address responsibility sufficiently to clarify the extent to which the investor or the custodian is responsible for any underpayment of tax in cases where the investor provides the custodian with incorrect information. This leaves custodians and investors with a significant level of uncertainty regarding liability to any subsequent assessment of tax, interest, and penalties. This uncertainty has led to protracted debates and delays in agreeing trading terms between counterparties.

More fundamentally, where custodians have no role in respect of a transaction, practices vary widely in respect of whether the custodian is even privy to knowledge about a transaction or can be relied upon to process a tax relating to that transaction. Where a custodian need not be obliged under legal or regulatory requirements to settle transactions through relevant securities systems, or hold instruments in physical or book-entry (dematerialized) form, any involvement by the custodian is purely coincidental: it is a function of the contractual relationship between it and its customer. Consequently, there are many transactions, such as exchange-traded derivatives, where a custodian may facilitate payment of cash in respect of customers' obligations, but the custodian does not maintain a definitive record of "purchases" or "sales" of such transactions, nor does it hold the instrument in custody. Moreover, there are many transactions which do not involve a custodian or even a broker: these include OTC instruments that are not cleared. In these cases it is clear that a custodian should not be relied upon as an "accountable party" where transacting counterparties would not use or appoint a custodian in carrying out a transaction.

Another key practical challenge with the French FTT is the application of tax to a trader's net position. Too often no single party will have the ability to track or report this given the ability of trades in the same instruments to be executed and settled through different brokers, custodians and exchanges. With net trade information currently bundled by custodians and other counterparties when provided through to a CSD, it is frequently impossible for any one party to have the information needed to apply and report the tax on the net basis.

We urge the Commission to ensure any FTT system proposed be as simple to operate as possible, and to give proper consideration to:

- Clearly distinguishing between the accountable party and the liable party for the tax, ensuring that the responsibility for payment of the tax lies with the investor whose decision it was to execute the trade;
- Where relevant, clearly articulating how the responsible party for tax payment and reporting is to be identified with certainty in a chain of brokers and intermediaries;

- Clearly articulating that transacting parties are responsible for payment and reporting obligations where brokers or other intermediaries are not relevant;
- Clearly articulating in-scope transactions;
- The extent to which reliance can be placed on information and certifications of vendors, clearing and settlement agencies, clients, and counterparties (as well as in defining parameters regarding data or factual representations to the accountable party); and
- The content and format of evidence any party should gather and hold to demonstrate suitable due diligence;
- The availability of suitable data to the party held accountable for payment and/or reporting.

II. Scope and Applicability of Tax

It is imperative that there is clarity around the definition of any term critical to the determination of accountability or applicability of FTT. Without this clarity, it may not be possible to identify impacted transactions, and there would be a significant risk that the FTT is not applied correctly. The result could range from lack of collection, to double taxation of the same transaction. We stress that a consistent approach across adopting Member States is vital.

The scope of FTT under the original EC proposal was broadly drafted, applying to **financial transactions** that involve **financial institutions**, where at least one party to the transactions is "**established**" in an EU Member State. In order to apply an FTT based on the original proposal it would therefore be essential to identify:

a. Whether either counterparty is a financial institution and is established in an EU Member State:

   The definition of **financial institution** is very broad and covers investment firms, regulated markets, credit institutions, insurers, collective investment vehicles and their managers, pension funds and their managers, and defined Special Purpose Vehicles (SPVs). There was also an intention however to include entities which were carrying out certain activities as a "significant part of their overall activity", which might, for example, apply to the treasury function of large corporates, though not necessarily for every instrument type. As this latter element is not tied to a regulatory definition, there is a strong risk of differing interpretation creating a need to confirm status with counterparties on each trade rather than periodically at the client static data stage. A similar significant complication is caused by the tax scope, which suggests non-EU entities may become "EU-resident" where they trade with, e.g., an EU financial institution. The number of variables involved would pose great difficulties for automation and auditing of the tax and we urge the Commission to consider the practical challenges carefully in drafting the new proposal.

b. Whether the **financial transaction** is in scope of the FTT and if so whether it benefits from an exemption

Under the original EC proposal, FTT would apply on the purchase or sale of financial instruments and the conclusion or modification of derivative contracts. This includes sale and repurchase agreements, securities lending, structured products, and intra-group transactions, with only limited exceptions for transactions in the primary markets (debt and equity), spot fx, physical commodities, loans, deposits and most consumer products (e.g., mortgage lending, insurance contracts, consumer credit).

In our experience with the French FTT, the following caused the most difficulty: American Depositary Receipts (ADRs), Global Depositary Receipts (GDRs), derivatives, OTC transactions, convertible instruments, exchange-traded fund transactions (including proprietary trading by such fund), corporate action events, repurchase transactions, securities lending/borrowing transactions, transfers of collateral and re-hypothecation under prime brokerage arrangements.

The publication of a complete list of in-scope and out of scope ***security types*** may assist market participants to prepare their systems for the identification of all in-scope activity to the extent the proposed FTT is reliant on security type.

The Association suggests that to the extent that FTT will apply to a specific subset of securities, the EU should delegate a specific, designated vendor to provide the industry with not only a list of company names whose securities are subject to FTT, but also a complete list of security identifiers (International Securities Identification Number (ISIN) or Stock Exchange Daily Official List (SEDOL)) that includes all security types, such as Depositary Receipts (DRs), ADRs, etc. This is particularly important in cases where a security may be listed/traded outside its domestic market. In this regard the EU should, consistent with the ability under the existing EU Savings Directive, confirm that data provided by an information vendor can be wholly relied upon.

Alternatively, if the EU does not appoint a designated vendor as set out above, the relevant tax authority should make an official list of security identifiers available in addition to the names of the issuing companies in scope for the FTT.

Finally, and although we make no specific recommendation with regards to possible exemptions that may be introduced for certain classes of investors, we note that it is not uncommon for Member States to adopt widely differing interpretations to the meaning of, for example, pension funds.

The Association suggests that to the extent any exemptions are introduced terms must be clearly defined and not subject to individual Member States' interpretation.

III. Calculation, Remittance, and Reporting

The adopting Member States should consider a consistent, administrable approach to rules governing the calculation, remittance, and reporting of FTT. Members consider the following areas of particular focus in this area:

A. The very nature of the FTT on securities transactions would strongly suggest the need for a Straight-Through Processing (STP) model reporting solution utilising current messaging infrastructure rather than a Comma Separated Variable (CSV)-based reporting method. The CSV reporting method has been one of the biggest challenges faced by market participants and has resulted in a highly manual reporting process prone to error. As such, in our experience as custodians with other similar types of taxes on transactions, a SWIFT-based reporting solution would facilitate greater efficiency and completeness of information.

B. There should be a clear mechanism for the reporting and payment of tax, including the extent to which the scope of FTT will apply on transactions that occur outside of EU jurisdictions.

In the event that EU Member States elect to make the FTT applicable to securities traded and/or settled outside the domestic market, there needs to be a specific mechanism for the Accountable Party to be able to report the tax and effect the payment to the tax authorities. Ideally, as in the UK, implementation requirements should leverage off of local market and depository infrastructure to ensure that requirements are clear and efficient. This will be particularly relevant should global depositories elect not to participate in the reporting/collection chain. For example, a reporting or remittance structure may be impaired should an International Central Securities Depository (ICSD) or CSD elect not to participate and "step out" of the chain. Consideration should be given in this regard to the extent that both dually-listed securities as well as Depository Receipt programs are deemed in-scope for FTT: ideally, the reporting and payment process should be the same for all transaction types and be facilitated through one mechanism (e.g., market infrastructure). If this is not achievable, the reporting and payment process and format required should at least be consistent.

C. The EU Member States should also consider that the trading of shares outside the domestic market may be denominated in currencies other than the Euro. As foreign exchange rates can fluctuate, the EU Member States should specify how the foreign exchange rate for the conversion to Euro should be established, including the fixing date and the benchmark rate to be used.

D. To the extent netting of liabilities is allowed, AGC members urge Member States to adopt a consistent approach to netting that among other things would specify whether netting is

mandatory or voluntary and provide guidance on how netting should be conducted when clients use multiple brokers for multiple daily transactions.

E. AGC members urge Member States to address whether and how rounding should be applied when calculating the applicable tax base.

A consistent approach across Member States is essential. Based on our experience with the French FTT, AGC members feel that the rounding model should be specifically addressed in the legislation.

F. AGC members stress that reporting/payment deadlines should be based on business days at month-end, not calendar days. In the case of the French FTT, trades are reported on the fourth calendar day following month end. This deadline is already quite tight. It becomes tighter when the fourth calendar day falls on a weekend or long weekend. Aggressive deadlines put undue pressure on parties with no added benefit and potentially additional risk of committing errors. By simply stating the deadlines in business days, such issues may be mitigated to some extent, provided of course this term is understood and applied consistently across the participating Member States.

G. AGC members feel that any EU FTT must provide for a clear and logical reporting path for financial institutions to declare and pay the necessary tax. The reporting path should also be easy to understand and applied consistently across EU Member States. At a minimum, a clear and logical reporting path should entail:

a) A central party (whether per country or EU-wide) to which all financial institutions can report and pay directly;

b) A simple, consistent reporting format;

c) Clear guidance on which financial institution is responsible for reporting in all situations and what information must be provided to it by counterparties to the relevant trade. To date there has been much uncertainty around the reporting path for French FTT declarations. While Euroclear France is charged with being the collection agent for French FTT, it is unclear whether Accountable Parties who are not Euroclear France members can report directly to it or via the settlement chain. As a result of this uncertainty, parties potentially would have to report via several different local agents, adding unnecessary complexity, cost and tighter deadlines. The format for reporting used is also laborious to complete and difficult to get into the correct format, and this has resulted in many submissions during the test period failing.

H. EU Member States should provide guidance on the reporting mechanism to the market far in advance of the reporting deadlines. If the Accountable Party must report and pay tax

directly to the tax authority, these procedures should be clearly defined, communicated early to the market for detailed consultation, and made available via translated documents.

IV. Timelines, Guidance, Language and Use of Defined Terms

The adopting Member States should ensure that there is sufficient time given to the global industry to implement any new FTT, and to allow a grace period where it makes sense to do so. To this end, adopting Member States should agree to a common timetable regarding implementation, provision of legislation and domestic guidance.

We would advocate, and strongly recommend, that a common timetable be agreed and adhered to by which adopting Member States release their domestic legislation and guidance notes. Any lack of clarity or delayed guidance would present challenges in defining a structure for the Association's members and their clients to fully comply with obligations under the EU FTT. A common timetable would provide a clear and agreed time frame for relevant parties to ready systems and infrastructure in anticipation of the EU FTT.

The EU FTT law is likely to impose numerous obligations upon investment services providers and securities account holders not resident in the adopting Member States. Should the EU FTT be approved, notices will be provided in Members States' native languages. A significant difficulty that occurs when trying to understand the legislation and guidance notes that fiscal authorities issue is that only a home country language version is produced. Typically this is subsequently translated by unofficial means, and some time later released in an official translated capacity. Given the number of countries looking to adopt the EU FTT and potential time delays if only home country languages are used, we would advocate, and strongly recommend, simultaneous English language version releases of official EU FTT related material in order to reduce potential time delays, miscommunication and misunderstanding. This could be coordinated via the European Commission.

The tax codes of adopting Member States vary significantly and considerable time is spent by the Association in analysing changes and legislation which are country specific. To the extent that the EU FTT is introduced it would be extremely helpful that where existing defined terms exist in national tax codes, these terms are incorporated as much as possible as part of EU FTT implementation, rather than leaving such terms to interpretation. This would help to ease difficulties with implementation.

V. Experience with Other Transaction Taxes and Potential Double Taxation

While the Association does not wish to comment on the economic merits of how tax is structured, we do have some practical considerations given our experience with various other transaction-based taxes.

The majority of transaction taxes worldwide generally seek to tax an investor purchasing equities issued by companies headquartered in a single, local jurisdiction. Some examples of this are:

1. The recently introduced French FTT applies only to equities for French headquartered companies with a market capitalization of greater than 1 Billion EUR.

2. The UK Stamp Duty Reserve Tax (SDRT) applies only to equities for UK domiciled companies.

3. Ireland imposes a Stamp Duty on the transfer of shares in Irish incorporated companies.

4. Hong Kong applies a Stamp Duty on both the purchaser and seller of local companies' securities (including equities and Hong Kong denominated bonds).

5. Singapore applies a Stamp Duty on the transfer of shares in Singapore incorporated companies.

It is rare for a transaction tax to apply based on the residency of the parties in the transaction per the European Commission proposal in its current form. One such example is Switzerland where Stamp Duty applies when one of the parties involved in the transaction is a Swiss-resident securities broker within the meaning of the stamp tax legislation and is involved in the transaction as party or intermediary.

The way in which the tax is structured will potentially have a large impact on the extent to which implementation of the tax can be effected in a manner consistent with the intent of the rules. Areas of consideration noted by Association members follow:

The current European Commission proposal seeks to tax any transaction where an EU resident is the buyer or seller and there is a financial institution in the chain. It is difficult to understand how such a system could be administered easily. Logically, we would assume that a broker would need to report and pay any FTT. This gives rise to the issues outlined above. If the broker will be primarily responsible for reporting and paying the tax, the custodian should not then have any reporting or payment obligations. This would remove administrative burdens and operational risks arising from custodians and investors having to report and pay the tax on such transactions on an ad hoc basis. This would also reduce the risk of confusion over which parties are accountable for reporting, as only the broker will ever have reporting or payment obligations. This would ensure a more robust process. In any case, we believe that the costs of trying to implement a tax to apply to the relatively small number of transactions not utilizing a broker (e.g., OTC) would likely exceed any benefit in tax revenues to the Member States of the EU.

When taxing in this way, consideration must also be given to how the tax would interact with transaction taxes already in place. As an example, the scope could result in double taxation where countries already have a transaction tax regime. For instance, an EU resident purchasing a Hong Kong stock through an EU domiciled broker would give rise to EU FTT as well as Hong Kong Stamp Duty.

We would encourage the Commission to carefully consider the route they wish to follow, taking into account the practical aspects of how the tax would be supported and collected as well as the fiscal

policy elements. A financial transaction tax which is complicated and difficult to support (whether through a financial institution as a custodian, broker, both, or neither) will result in additional risk for both the institutions and clients, and additional costs, and it could result in an inefficient transaction platform.

Based on previous experience in relation to transaction taxes in the European Union and globally, difficulties encountered by the industry in the implementation of a new transaction tax primarily derive from a lack of sufficient time to understand the necessary operational requirements involved and the consequent time required to adapt through implementation of new systems and infrastructure to support payment of the tax. Furthermore, it is necessary to engage over a period of time with fiscal authorities to obtain guidance in specific areas and especially in relation to complex transactions.

Given the period of time during which adopting Member States would have to implement a potential Directive into their domestic tax code, ensuring sufficient clarity and time for consultation and engagement with industry participants and intermediaries may help to alleviate the problems that may otherwise arise in the short timescale for implementation as envisaged. Even with relatively long lead-time prior to implementation of an EU FTT, it is imperative that adopting Member States proactively and collectively use the time available to them in consulting with industry in setting out guidance on how the EU FTT will operate domestically. It is important not to underestimate the time required to fully implement a new transaction tax. Fiscal authorities should be aware that industry groups and interested parties will ask for clarification on a range of matters and time should be set aside to provide necessary guidance.

* * * * *

The Association members appreciate any consideration that the Commission and Member States may give to the comments provided above. We would be pleased to provide further information upon request in relation to any of the points raised or to meet with Commission or Ministry staffs to discuss this letter.

Sincerely yours on behalf of the Association,

Mary C. Bennett
Baker & McKenzie LLP
Counsel to the Association

Addendum

ADDENDUM

Key FTT Questions

1. Who is tax payable by?

1.1. Which financial institutions are liable for FTT?
1.2. Does residence of institution govern liability to FTT?
1.3. If so, what are the rules for identification (e.g., head office, branch)?
1.4. Where more than one taxable person is involved in a transaction, confirmation sought that FTT is only payable once?
1.5. Does the position differ if such intermediaries act as principal or agent?
1.6. What are rules for identifying the liable party in such cases?

2. What instruments are taxable (non-derivative)?

2.1. Will there be a central identification of taxable instruments?
2.2. What is the position where instruments reflect both taxable and non taxable instruments (e.g., index-linked securities)?
2.3. Are ADRs and GDRs taxable instruments?
2.4. If ADRs and GDRs are taxable, will the French or UK model be followed?

3. What instruments are taxable (derivatives)?

3.1. Will there be a definition of a derivative?
3.2. What are the rules for identifying which derivatives are taxable?
3.3. What is the position where a taxable derivative reflects both taxable and non taxable instruments (e.g., index-linked securities)?

4. What transactions are taxable?

4.1. Are only sales/ purchases taxable transactions?
4.2. Confirmation sought that "temporary transfers" (e.g., stock loan, repo, collateral) are not subject to FTT
4.3. For derivatives, at what stage is liability generated (e.g., inception, alteration, closing out, exercise, etc.)?

5. What is the tax base?

5.1. At what stage is tax base determined – trade date or settlement date?
5.2. If settlement date, it should be confirmed as to calculation of net taxable base where purchases and sales of taxable instruments settle on the same day.
5.3. What is the taxable base for derivatives?
5.4. For derivatives leading to delivery, confirmation sought that no double charge.

6. What exemptions are available?

6.1. Where any exemption is based upon set criteria (e.g., status of counterparty, type of security) will there be centralised lists of those qualifying for exemption?

6.2. What evidence is expected to be obtained by taxpayers to support exempting transactions in the absence of centralised lists?

7. Tax payment, collection and reporting?

7.1. Payment obligations – who, when, where?

7.2. Reporting obligations – what, when, to whom?