THE ASSOCIATION OF GLOBAL CUSTODIANS

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13 July 2012

**VIA E-MAIL**

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**Re: French Financial Transaction Tax**

Dear Madame Coupet and Monsieur Magnant,

We write on behalf of the members of the Association of Global Custodians (the "Association")[1] to convey the members' concerns regarding the implementation of the Financial Transaction Tax (FTT) in France as established through Article 5 of the Amended Financial Bill No. 2012-354 of 14 March 2012 (the "Finance Bill"), which

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[1] The Association is an informal group of eleven global banking institutions, listed on the letterhead above, that conduct significant custodian services and related asset-servicing functions on behalf of cross-border institutional investors worldwide, including non-resident institutional clients investing in France.

presents challenges for the Association members as custodians due to the lack of sufficient time to prepare for the launch of this new tax.

The Association is aware that various other industry groups have submitted comment letters to you concerning the implementation of this tax. Specifically, we reference a letter sent to you by the British Bankers' Association (the "BBA") and the letter issued by the Association for Financial Markets in Europe (the "AFME"), both dated 6 July 2012 (the "Letters"). For your convenience we attach hereto a copy of the Letters. The Association concurs in the views and suggestions conveyed in the Letters. For the purposes of the Association members' comments, we set out below the key areas requested for clarification and confirmation, as noted in the Letters, around the issues that most significantly impact the Association's members and their clients.

The effective date of the tax is August 1, 2012, which is less than a month from now, and there remain a number of items which are yet to be finalized at the market level. Accordingly, the Association members strongly recommend that the implementation of the FTT be postponed to allow sufficient time to understand the finalized provisions of the Finance Bill and to introduce a mechanism to ensure compliance with the tax obligations set forth therein.

To date, there are a number of items which require clarification at the market level (including an explicit list of securities impacted and recognized foreign markets, securities and transactions deemed to be in-scope, and details on the identification of liable parties), and which impact the ability of the Association members as custodians and their clients to define a framework to comply with the obligations of the FTT.

The framework for the application of the FTT is quite complex for Global Custodians and their clients in that the identification of the withholding and reporting entity depends on how the transaction is executed, where the transaction is executed, and the number of parties involved in the chain of the transaction. Accordingly, additional lead time is necessary for the Association's members and their clients to understand and introduce an appropriate mechanism to ensure compliance as the tax is not directly levied at the point of trade execution similar to other markets that apply a transaction tax. The Association members and their clients need the final administrative guidelines to be issued and the guidance on the best practices from the AMAFI and AFTI, which are only expected mid-July, to appropriately introduce procedures to comply with the FTT. The lack of clarity on the above items is presenting challenges in defining a structure for the Association's members and their clients to fully comply with the obligations under the FTT. Some items of concern are more explicitly noted below:

**(1) Securities Lending**

Clarification on the requirement to declare securities lending transactions, given that these transactions are reportable under another means, and are not subject to FTT. Reporting of both legs of these transactions will require significant efforts to introduce a mechanism to support this requirement.

**(2) American Depositary Receipts**

Clarification of how the collection of this tax will be accomplished in the United States given there is no infrastructure in the market to collect such tax.

**(3) Collateral**

Clarification on the applicability of the FTT on in-scope securities used as collateral for securities lending transactions, swaps, or repurchase agreements regardless of whether such collateral settles outside of the main agreement governing such transactions, and the consideration to remove the requirement to report these exempt transactions.

**(4) Intra-day Transaction Netting**

Clarification on the technical and operational application of netting of in-scope transactions on a given day conducted through various brokers. Clarity is required on which broker(s) are responsible for the tax and reporting to Euroclear France.

**(5) Accountable / Liable Party**

Clarification on the accountable party for tax withholding and reporting given the complex framework for the application of the FTT in the legislation. The obligation to withhold the tax and report on in-scope transactions is not designated to a single party, and as such there is ambiguity as to who is the accountable/liable party and the process to follow. The withholding and reportable party differs based on the type of transaction, number of parties which are in the chain of the transaction, and whether the transaction is executed within or outside of France. This presents increased liability and risk to the accountable party who would have to determine a mechanism to confirm with its clients all transactions have been accounted for in order to ensure compliance with the assigned obligations.

Clarification on the party deemed to be the securities account holder. Interpretations seen by Association members have indicated the Global Custodian is considered the securities account holder, while technically, the local subcustodian bank

holding the securities for the Global Custodian locally maintains the securities account at Euroclear France. It would therefore seem logical to identify the local subcustodian bank as the securities account holder, who would then be the accountable party for those transactions that are executed without a broker. The local subcustodian bank could then ensure access to client assets via its client agreements.

**(6) Scope of Instruments**

Clarification on the overall scope of securities for which the FTT should be applied. The Association notes that the regulator will only publish a list of companies with a market capitalization exceeding one billion euro; however, this list would not contain a security identifier and would therefore leave room for interpretation. By adding this additional element, the Association members believe that ambiguity vis-à-vis those instruments in or out of scope could be avoided.

**(7) NCBO Portfolio Transfers between Custodians**

In the case of "No Change of Beneficial Ownership" ("NCBO") portfolio transfers between custodians, there is a transfer of legal title (although not beneficial interest) without the involvement of an ISP. The Association requests confirmation that such transfers of title are not reportable, and also confirmation of the documentation custodians are required to retain to evidence that the transfer was indeed NCBO, given that the securities account holder in that case would be the party liable to FTT.

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Based on the above, the Association members respectfully repeat their strong recommendation to delay the introduction date of the FTT to have more time to obtain clarity on outstanding questions and also allow the market more time to prepare its systems and infrastructure for the introduction of the FTT.

The Association greatly appreciates the opportunity to provide the comments set forth above.

Sincerely yours,

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

Attachments

The voice of banking
& financial services

**BBA comments on the Instruction to present the tax system on financial transactions established by the provisions of article 5 of Amended Financial Bill No. 2012-354 of 14 March 2012 for 2012**

The British Bankers' Association (BBA) is the leading association for the United Kingdom (UK) banking and financial services sector, representing over 200 banks, which are headquartered in 50 countries and have operations in 180 countries worldwide. These member banks collectively provide the full range of banking and financial services. The International Custody Tax Liaison Group (ICTLG) is affiliated to the BBA and is the principal forum for custody tax practitioners operating out of the UK [1]. Further information on Global custody services is provided in Annex 1.

The BBA welcomes the opportunity to contribute constructively to the French Government's development of the instruction for the 'taxe sur les transactions financières' ('TTF') established by the provisions of Article 5 of Amended Financial Bill No. 2012-354 of 14 March 2012 ('the legislation'). We would, of course, be happy to clarify any points raised in these comments, or to discuss further any issues related to our understanding of the intentions underlying the instruction.

**General Comments**

BBA members have significant concerns that there is insufficient time to fully implement the required system changes before 1 August 2012, to support compliance with their obligations under the TTF. We have articulated a number of issues below and there are also several operational aspects listed in Annex 2 that remain unclear with less than one month until the implementation date. Given that final administrative guidance has not yet been issued, and that guidance on best practice from the French industry representatives AMAFI and AFTI are also not expected until mid July, it is currently extremely challenging to implement the required processes to ensure compliance with the obligations on custodian banks under the TTF.

The TTF law imposes numerous obligations on non-French investment services providers and securities account holders. However, whilst we have seen an English translation of the draft guidance from the Direction Generale Des Finances Publiques, which provides some much welcome clarity on certain administrative aspects of the TTF, there remain a number of references to the TTF legislation and the French Monetary and Financial Code which make it very difficult to fully interpret the detailed technical requirements. We, therefore, respectfully request that you make available an official English translation of both the relevant tax legislation and corresponding guidance, or confirm where this may be found if already in existence.

In recognition of the challenges the industry is facing, to implement system changes in spite of ongoing uncertainty and in what is a very short timeframe, the BBA additionally requests an extension to the interim schedule beyond the proposed three months. We would urge that the interim schedule is extended to the end of the calendar year 2012. Furthermore, we would ask that the French Government consider suspending the application of any penalties during the transitional period. This will enable the industry to familiarise itself with the practical requirements of the TTF and adapt accordingly as these inevitably evolve post-implementation, without enforcing unnecessarily punitive measures.

[1] ICTLG members include most of the major global custodians (Bank of New York Mellon, BNP Paribas, Brown Brothers Harriman, Citibank, Credit Suisse, Deutsche Bank, HSBC, JPMorgan Chase, Northern Trust, Royal Bank of Canada, State Street Bank & Trust Co. and UBS AG)

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The commentary below provides further information regarding specific concerns around the implementation of the TTF for custodian banks.

**Securities Lending**

As BBA members currently understand the legislation, both legs of a standard repurchase or securities lending agreement (i.e. stock lent out and same stock returned) involving in-scope French securities would be exempt from the TTF.

BBA members further understand the draft instruction to mean that the same transactions would be reportable to the French tax authorities by either the broker to the transaction or, if no broker is involved in the transaction, the Local (i.e. French) sub custodian of the lender and the borrower, using information provided by the main custodian as appropriate. It is currently unclear in what format this information is to be provided to the French Tax Authority.

BBA member's interpretation of the legislation is that reporting should indicate the exempt status of the transaction in the reporting, but it is unclear from the draft instruction how this will be achieved in practice. One possible way of achieving this would be the use of a one off "tick the box" declaration, however if any additional information is required then this may not be appropriate. The BBA would request further clarity on this point to ensure custodian banks are compliant with their obligation under the TTF.

We would also respectfully request that, due to the operational burden of reporting exempt repurchase and securities lending transactions, such transactions should be excluded from the requirement to report. The BBA understands that information regarding securities lending transactions is already reported and therefore it would appear to be an unnecessary requirement leading to duplicate reporting. Additional reporting of this information would require substantial development issues in establishing the necessary reporting infrastructure, for what we would perceive to be little benefit.

**Collateral**

It is currently not clear from the draft guidance whether French in-scope securities provided as collateral for either a securities lending transaction, swap or repurchase agreement would be subject to the TTF. As BBA members currently understand the law, collateral which is provided as part of a securities lending, swap or repo transaction, and can therefore be shown to be a temporary transfer of securities, should be exempted from the TTF. As the regulations currently stand, if collateral is provided in support of a transaction, but is settled outside of the main agreement, it does not appear that this same collateral would be able to benefit from the temporary transfer of securities exemption.

Due to this perceived mis-match, it appears that current market practice will be to exclude French securities from the list of acceptable collateral securities with effect from 1 August 2012, where they may not be able to meet the current criteria.

The BBA would respectfully suggest that confirmation is provided that collateral securities are exempted from TTF if that was the original intention. If collateral securities are to be exempted from TTF the BBA would request that, due to the operational burden of reporting exempt collateral transactions, such transactions should be excluded from the requirement to report.

**Broker Payments**

There is currently a great deal of uncertainty amongst financial institutions around the correct process for identifying payments in instances where payments will be facilitated by trading with various brokers. The BBA's interpretation of the legislation is that it requires the total net position to be subject to tax. Under this interpretation it is unclear whether the tax would be charged for both brokers, and which broker would be responsible for collecting the fees.

Similar to the above, the current framework for the implementation of this tax is quite complex and could lead to issues with compliance of the obligations based on the different parties involved. One potential solution to this could be to have a single party responsible for the payment and reporting of the transactions to Euroclear France to avoid any ambiguity on the "account/liable" party. Or, a facility similar to Euroclear UK whereby the tax is handled as a stamp duty and processed directly by the Central Settlement Depository (CSD) by coding incorporated into settlement instructions.

**Identification of Accountable parties**

The BBA's understanding of the legislation is that the tax applies on securities that result in the transfer of legal ownership. Such transfer occurs when securities are settled with the CSD.

Commonly a CSD will hold accounts for each direct participant; each participant account will reflect the net position of all activity that has occurred for its customers. In the case of Global custodian banks, the account will reflect the total position of its direct customers.

Securities of customers of the Global custodian bank will generally be held in that custodian's nominee name, who in turn uses the services of a Local custodian bank to finally settle the purchase and sale transactions with the CSD.

As per our current understanding of both the legislation and the draft instruction, reporting and payment of the TTF is the responsibility of either the Broker or, for OTC trades, the investment services provider ('ISP') i.e. custodian bank. However, as described above, the securities settlement transactions will always flow through the various custodian banks resulting in no direct correlation between the transfer of legal ownership and the reporting and payment of the TTF.

As a result, it would appear that the ability to accurately reconcile TTF positions with the underlying transactions settled at the CSD would result in confusion and likely incorrect identification of accountable parties.

Given that Global custodian banks will, in many instances, hold the book of records to identify underlying trading activity, BBA ICTLG members are extremely concerned that undue liability could be placed on its members.

As we have already noted above, the imposition of a transaction tax that is not directly levied at the time of the transaction is risk and error prone and we would encourage consideration of a solution that enables identification and payment of the tax to be executed at the time of the trade execution.

**Conclusion**

The BBA hopes that the comments above provide sufficient clarification regarding the covered subject matters. We remain at your disposal to provide any further detail on these points or to discuss these matters further.

**6 July 2012**
**British Bankers' Association**

**Annex 1 – Global Custody Services**

In providing Global custody services, BBA members routinely seek appropriate tax relief on behalf of their custody clients. The group also works with overseas tax authorities to ensure the smooth operation of procedures for dealing with withholding tax and to eliminate or minimise existing discrepancies in the current tax relief processes and regimes from jurisdiction to jurisdiction.

As you may know Global custody services essentially comprise the settlement and maintenance of securities assets, the handling of post-settlement events such as income payments and corporate reorganisations and associated cash management. In order to provide such services, our members will normally appoint a bank established in the country of investment to facilitate settlement of securities assets and provide post-settlement asset servicing. These banks are referred to as sub-custodians. The Global custodians' clients will not be direct clients of the sub-custodian and will look to the Global custodian to service their requirements. Such clients may be entitled to the application of lower rates of withholding tax on income events pursuant to a relevant double taxation treaty (DTT) or under domestic law. A Global custodian will normally facilitate access to such lower rates of withholding tax – typically by submitting relevant information or documentation to the Local sub-custodian or paying agent.

**Annex 2 – Operations' Requests for Additional Clarification:**

In seeking to apply the instructions provided BBA members have identified a number of areas where it is unclear how these will be treated under the legislation. We have summarised these below:

**TTF Established Exemptions**

It is unclear whether operations processed by a clearing house or CSD are considered exempt from the TTF.

**TTF impact of Mt54X messages on Custodians and IMs**

It is unclear whether the tax will be collected and paid separately from the trade settlements. This may have an impact on Mt54X messaging.

It is unclear whether clients will be responsible for sending the tax details to custodian banks in order to match the net amounts for the bank. If the clients are responsible for sending tax details to the custodian in order to ensure each match the net tax amounts due to the brokers, this may give rise to administrative and operational concerns.

**TTF Pending Items Awaiting Clarification:**

**Scope:**

- We would respectfully request a list of companies that meet the criteria to apply TTF
- We would respectfully request confirmation on whether trading or issuance of ADRs / GDRS will be considered in scope for TTF application
- We would respectfully request confirmation on which transactions related to corporate actions, if any will be in scope of the TTF application
- We would respectfully request confirmation as to whether TFF tax may be subject to Value Added Tax (VAT)

**Payment:**

We would respectfully request that the French Tax Authorities:

- Define payment procedures to process payment with local brokers and custodians
- Define payment procedures for transactions paid in non-Euro currencies
- Define the payment process for transactions settled in regulated markets outside of France
- Provide confirmation as to whether deadlines are to be based on business days or calendar days

**Declaration:**

We would respectfully request that the French Tax Authorities confirm the following:

- The format of tax the declaration approved by the French Tax Authority
- The method to be used to submit the tax declaration
- How to identify the responsibilities of investors and accountable parties

**Collection:**

We would respectfully request that the French Tax Authorities provide further information on the treatment of:

- Transactions paid in non-Euro currencies
- Transactions settled in regulated markets outside of France

**Accountable Party:**

We would respectfully request that the French Tax Authorities:

- Provide clarity regarding the responsibilities of the accountable party for ISPs and account holders
- Clarify the meaning of the account holder, specifically, whether this is the Global custodian or Local sub custodian

**Netting:**

We would respectfully request that the French Tax Authorities:

- Define the process to be used to net same day purchase and sale taxable transactions
- Clarify if the netting process is mandatory or voluntary

**Reclaim Process:**

We would respectively request clarification on the operation of a reclaim process in the event of an overpayment.

afme/
Finance for Europe

**Official Tax Bulletin (3A) – AFME comments**

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6 July 2012

AFME is grateful for the opportunity to provide initial comments on the draft Guidance from the Direction Generale Des Finances Publiques.

The document aims to provide much needed clarity on how investment service providers should ensure they correctly calculate and pay this tax.

Before discussing the draft regulations in more detail, we have the following priority remarks to make on the introduction of the French FTT:

1. AFME is concerned about the timing of the introduction of the FTT especially when neither the rate nor the precise scope of the tax will be known before the 26 July, when the revised package is likely to be approved in the French Senate. With less than four weeks from the introduction date, there is still much uncertainty about many aspects of the tax. We would therefore strongly recommend delaying the introduction date of the tax to have more time to provide clarity on outstanding questions and also give the market more time to prepare its systems and infrastructure for the introduction of the FTT.

2. AFME believe there is still significant uncertainty as to where the liability for paying and reporting the tax falls, particularly where, for example, there is more than one broker in a chain of transactions. We strongly recommend that the final regulations provide clarity by stating that the liability for both payment and reporting falls on the **buying ISP.** We consider that such additional clarity would be in the interests of the French administration and of market participants.

3. AFME understands that it is intended that the tax should apply when the purchased securities are recorded in the purchaser's securities account i.e. the trigger point is settlement, although the liability rests with the buying ISP who may choose to pass on the costs. On this basis, the buying ISP would consider the application of FTT to each client's orders and would only net intra-day buys and sells on a per ISIN and per client basis. It is not possible for ISPs to net trades entered into on the same date by a particular client with different ISPs; in fact this would render the FTT inoperable as ISPs will not have sight of the overall net position of a client's daily trades.

4. We understand that the French government is intending to bring ADRs into the scope of the FTT. We have outlined our concerns about this in more detail below; but in particular we would note that there is no infrastructure in the US to implement such a charge.

Association for Financial Markets in Europe

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5. In the absence of it being possible to grant intermediary exemption status to a whole investment firm, AFME believe that, for practical reasons, the market making exemption should be granted on a desk level rather than on a transaction by transaction basis – this is more consistent with our interpretation of the current EU Short Selling definition of Market Making. AFME feels that it is important to have a single definition of Market Making across all European Regulation and the current definition in the draft regulations would undermine current trading practices. AFME members are particularly concerned about the requirement to prove a link between market making trades and a client request as this would undermine the ability of members to undertake hedging on a portfolio basis and to facilitate liquidity through the anticipation of customer demand. Holding inventory in anticipation of customer demand is an important part of the market-making role and is essential in increasing liquidity and reducing volatility in the French equities market. It also plays a crucial role in providing best execution for clients.

6. AFME would like to have further confirmation of the legal status of the "Tax Bulletin". In particular the regulations should confirm that an ISP can rely on the bulletin in audits.

7. In the legislation and regulations, frequent reference is made to provisions in French commercial and financial law which are unfamiliar to many firms outside France which are liable for paying the tax. We would therefore in general recommend including the necessary wording from the French commercial and financial law in the regulations directly.

8. AFME also anticipates the publication of guidance in relation to Title 2: 'Tax On Orders Cancelled Under High Frequency Trades' and Title 3: 'Tax on Sovereign Credit Default Swaps'. Given that we are now less than four weeks away from the tax entering into force, AFME suggests that publication of further guidance on these outstanding elements should be made an immediate priority.

AFME's response to specific issues raised in the guidance can be found in the Appendix to this letter. The list of concerns we raise is not exhaustive but it is hoped that it provides a better insight into the level of concerns raised by AFME members in their work to prepare for the introduction of the law. Given the tight timetable, we would welcome the opportunity to provide further comments or to raise further questions.

We are submitting our response in English initially, and will follow up with a translation in the coming days.

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We would hope that ultimately, if an investment firm has implemented a robust regime to charge, collect and remit the tax and the process has been implemented with adequate due diligence, banks should be held harmless for any failures to properly calculate and remit the tax, if such failures can be demonstrated to be inadvertent or due to uncertainty in the law.

We would be very pleased to discuss this matter further with you by arranging a call or a meeting.

Yours sincerely,

**Richard Middleton**
**Managing Director, Tax**

## Appendix

### Chapter 1: Scope of Application

Section 1: Securities included in scope

Point 5:

We were surprised by the statement that ADRs are within the scope of the tax. According to the law "assimilated equity securities" are liable to the Equity FTT only if they are issued by a French company with market capitalisation of more than €1 billion. Since ADRs are not issued by the underlying French issuer, AFME is of the view that in order for ADRs to be in scope, a change in the primary legislation would be required.

If ADRs are to be included in the scope of the FTT, we foresee many problems. It is impossible to see how the French tax administration would be able to collect this tax in the US as there is no infrastructure in the US market to implement such a charge. This may lead to significant disruption in the market for ADRs referencing French stocks and shares. For more details on the problems our members expect if the French FTT would be extended to include ADRs, we would like to refer to the note we shared with you on 27 June. Please find this note attached to this letter.

Point 8:

This article refers to the recognised foreign markets as defined by the French Monetary and Financial Code (MFC). To ensure consistent compliance with the law, we would like to ask for an explicit list of recognised foreign markets, either in the final regulations or in a separate decree, which would fall within the scope of the application.

We would like to ask, within this section, for further clarification on how the FTT applies to ETFs (Exchange-Traded Funds). We understand that the purchase of a unit in an ETF is out of scope but that the transfer of shares on the creation and redemption of the ETF units is subject to FTT unless one of the exemptions applies (ie the same exemptions as for share transfers generally). We would also request the same clarity in relation to ADRs?

We would also like the regulations to specifically confirm that cash settled derivative transactions are out of scope. We would reiterate that the list of companies in scope should be published prior to the list becoming effective in order to ensure the market can operate effectively and consistently. On this point, we are pleased to see that the administration has demonstrated that it understands the concerns by introducing proposed amendments in the draft Financial Amendment Bill for 2012.

Section 2: Acquisition of equity securities or assimilated instruments

Point 10:

We would also like to request clarity on the meaning of the statement that "acquisition includes the purchase (including within the context of an option or forward instrument requiring a contract)"?

We had understood that derivatives (listed or otherwise) were not within the scope of FTT when purchased or transferred and the FTT was only due when they resulted in a transfer of ownership in the underlying shares which are in scope (e.g. on exercise of an option)?

Clarity is required as the position must be contrasted with bonds with share or subscription warrants attached (OBSA and OBSAAR) which are said to be in scope but are then given a specific exemption from FTT on acquisition.

Where derivatives give rise to transfer of ownership of shares which are in scope, is it possible to claim the market making exemption based on the purpose for which the derivative was entered into or the shares were acquired?

Point 12 and 13:

As noted in paragraph 3 of our covering letter, AFME understands that it is intended that the tax should apply when the purchased securities are recorded in the purchaser's securities account i.e. the trigger point is settlement, although the liability rests with the buying ISP who may choose to pass on the costs. On this basis, the buying ISP would consider the application of FTT to each client's orders and will only net intra-day buys and sells on a per ISIN and per client basis. It is not possible for ISPs to net trades entered into on the same date by a particular client with different ISPs; in fact this would render the FTT inoperable as ISPs will not have sight of the overall net position of a client's daily trades.

Point 14

We understand that if arrangements are entered into which permit settlement to be deferred beyond the normal settlement date (e.g. Deferred Settlement Service) the liability to FTT (which falls on the ISP) will only apply to the transactions executed by the ISP on behalf of the client which actually settle.

Section 3: Conditions relating to the securities issuer

We understand the French administration won't provide a list of companies of which shares will be subject to FTT. However, we would ask the French tax administration to validate such a list as soon as established by Euroclear, market participants and vendors to provide certainty to the market and consistency between market participants. Such a list would need to be validated on an ongoing basis as updates to that list are made.

Point 16:

The equity shares and assimilated instruments falling within the scope of the FTT are those issued by a company whose registered office is in France. We would like to ask for further clarification on when a company is deemed to have its registered office in France as we understand that this is difficult to determine and there is no readily accessible information available to third parties? Which steps do ISPs need to take to establish that a firm has its registered office in France? It would be most helpful it the French administration would provide a list of companies that have their registered offices in France as this would give a public source that firms can rely on.

## Chapter 2: Exemptions

Section 3: Acquisitions performed under liquidity contracts

Our general comment on the market making exemption is that, in the absence of it being possible to grant intermediary exemption status to a whole investment firm, AFME believe that, for practical reasons, the market making exemption status should be granted on a desk level rather than on a transaction by transaction basis – this is more consistent with our interpretation of the current EU Short Selling definition of Market Making. AFME feels that it is important to have a single definition of Market Making across all European Regulation and the current definition in the draft regulations would undermine current trading practices to the detriment of end investors. We do strongly recommend focusing the regulations more on the provision of liquidity, than to limit providing liquidity by including many specific obligations.

In addition, to the extent any conditions outlined (in particular the requirement for a formal contract and meeting the conditions regarding systematic internalisers) are not specified in the legislation, we believe that it should be stated that fulfilment of these conditions will only lead to a simple presumption that the market making exemption has been met and is not mandatory.

Point 30a, situation 1:

The introduction of the specific regulation with regard to market making, requiring under activity (a) a formal agreement to provide liquidity with any specific platform is not practical and may be contrary to EU law and concepts relating to competition. (In addition even where a formal contract is in place the regulation states that "the liquidity provider must be continuously present on the market or have a minimal presence on the correspondent market amounting to at least 95% of the time on both sides of the order book during the continuous trading session" ; which is simply unrealistic, exchanges themselves should be left to set the parameters of their own liquidity provision schemes.

Current and proposed regulation in the EU recognise that market markers/liquidity providers exist in the market even where there is no specific contractual liquidity provision arrangement, and provide certain exemptions for this market making activity (for example as in the definition of market making in Regulation (EU) No 236/2012 (the "Short Selling Regulation") and in the proposed recast Markets in Financial Instruments Directive). We are of the view that the FTT should operate on a basis which is consistent with this approach. The Short Selling Regulation defines "market making activities" as "the activities of an investment firm, a credit institution, a third-country entity, or a firm as referred to in point (l) of Article 2(1) of Directive 2004/39/EC, which is a member of a trading venue or of a market in a third country, the legal and supervisory framework of which has been declared equivalent by the Commission pursuant to Article 17(2) where it deals as principal in a financial instrument, whether traded on or outside a trading venue, in any of the following capacities:

(i) by posting firm, simultaneous two-way quotes of comparable size and at competitive prices, with the result of providing liquidity on a regular and ongoing basis to the market;
(ii) as part of its usual business, by fulfilling orders initiated by clients or in response to clients' requests to trade;
(iii) by hedging positions arising from the fulfilment of tasks under points (i) and (ii);

Under Article 17, the investment firm is only required to inform its competent authority of its status as market maker in the relevant instruments. No requirement for a contractual

commitment to a venue is stipulated in the Short Selling Regulation. A similar interpretation of market making is also followed in the legislative proposal of the EU Commission of the recast Markets in Financial Instruments Directive (MiFID 2).

A requirement for such contractual commitment may contravene the requirements of Article 17 of the Short Selling Regulation. It may also contravene Recital 26 of the Short Selling Regulation which recognises that "market making activities play a crucial role in providing liquidity to markets within the Union and [... ] imposing requirements on such activities could severely inhibit their ability to provide liquidity and have a significant adverse impact on the efficiency of the Union markets".

Furthermore, assuming that certain markets introduce in the future such market making contracts for their members, this would incentivise those market making firms to direct client orders only to those markets, in order to provide their clients with lower execution costs. This may have the perverse effect of promoting markets which may not offer the best execution opportunities for those orders, thereby giving rise to deteriorating quality of execution for clients. This interpretation of the law may therefore present obstacles for brokers in complying with their best execution obligation under MiFID Article 21 as there is a distinction in the overall trading cost of executing as a result of the mismatch in the venues offering contractual liquidity provision.

The activity referred to also covers providing liquidity on all financial markets and not just the equities market. In many of these other financial markets there are no established platforms upon which trades are conducted, most are done OTC yet those markets operate efficiently precisely because there are market makers willing to hedge those financial contracts but outside the confines of any formal agreement. By imposing such a restriction in the regulations, firms are being asked to satisfy an impossible condition on the basis of the present offering of the key markets trading the relevant securities.

We are of the view that the requirement that there be a formal contract should be dropped and the actual market making activity should be looked to establish whether or not market making under activity (a) is actually taking place, thereby moving to a fact based test rather than a contract based test, in line with other applicable EU regulation/legislation.

Point 30a, situation 2:

The second situation relates to the supply of liquidity to the market within the framework of OTC activities. In order to be exempted from the FTT, the intermediary must meet the conditions relating to the qualification of systematic internaliser, as specified in article L. 425-1 of the French Monetary and Financial Code. We think it would be more equitable to use the MiFID definition rather than the FMC definition here.

Point 30 1b:

The paragraph appears to narrow the activities permitted by the market making exemption. In particular, the guidance states that an "intermediary's accumulation of stock to meet potential client needs is not FTT exempt. The intermediary must be able to prove a link between a client request and the purchases made on his behalf". This represents a major constraint on market making activities carried out by investment service providers.

Building inventory ahead of anticipated customer demand is standard practice in the firm's roles as liquidity provides/market makers. Using known corporate calendars, internal resources (sales and research) and experience as liquidity providers, firms make

subjective judgements about where prospective client activity will be. AFME believes clients are significantly more likely to buy and sell shares if they believe that they are able to find sufficient liquidity in a timely and simple fashion, this is the demand firms are trying to satisfy in their role as liquidity providers. Client feedback confirms the value that firms have in this. Providing this liquidity through prior inventory build is therefore a frequent occurrence because integral to the role of firms, especially as volumes have declined over recent years. Academic research accepts that illiquidity is associated with discounted value and the role of firms helps to support values in this context.

Also in the context of volatility this is an important point. The ability of firms to position themselves to meet anticipated customer demand plays an extremely important role in providing best execution for clients and reducing market volatility, especially around large re-balancing events such as changes to an index (where many index trackers will be obliged to place orders).

Such events are transparent to the market and as such intermediaries will attempt to judge client demand and position themselves accordingly in the run up to the event. This prevents having to execute very large orders into the market on the actual day of the event that would result in increased market volatility and inappropriate daily price movements, especially last to close in the auctions, as these funds, due to their nature, do not allow any tracking error - so will send such orders at the closing auction at market.

We believe if an intermediary can demonstrate that they are providing liquidity to clients they should be exempt from the FTT.

Point 30 2c:

AFME welcomes the clarification that a transaction undertaken in an underlying French share to hedge a position taken in a financial contract falls under the market making exemption. However, we are concerned about the link between the purchases made as part of the hedge transactions with the market-making activities mentioned in parts a and b which must be justified when hedge transactions cannot be performed on an individual basis. How should this link be justified? What sort of evidence is needed?

The regulations say that in this context, the trader may refer to his internal service organisation. A reference is made to French regulations. However, in other jurisdictions, local regulations might not provide this guidance. In the absence of eligible local regulations, we believe that internal guidance should be considered as sufficient. We hope that this would be an acceptable approach. We believe that equivalent regulations would otherwise be required for non-French firms.

Section 4: Intra-group transactions and restructuring operations

Point 3:

The acquisitions of securities between member companies of the same group which meet the conditions as set in French law are exempt from FTT. We believe that it would be important to also have a non-French equivalent of a group so that there is no requirement that any company is incorporated or resident in any particular country so the relief applies equally to international groups and is non-discriminatory. We would therefore request confirmation that the relief applies to transfers between associated companies where one company is a parent of the other or both are subsidiaries of another company.

Section 5: Temporary transfer of securities

Point 5:

Repos and securities lending/borrowing are exempt from FTT. We expect that these transactions should not incur the reporting obligations (for example a stock loan is not actually a purchase of shares for consideration, the ISP will borrow shares and collateralise its obligations (often with cash) to return the shares at the end of the stock loan period). We would like you to consider exempting the reporting requirements for repos and stock loans.

We would also expect transfers of collateral or rehypothecation under prime brokerage arrangements to be exempted, as these are temporary transfers in line with stock lending and repos. We would welcome clarification of this from the administration.

Finally, the regulation states that the acquisition contract includes an option enabling the seller to buy back the security at the initial selling price. However, the repo price doesn't have to be the original selling price; it can also be a fixed or formulated price. This should be reflected in the Bulletin.

Section 6: Transactions performed within the framework of employee savings

Point 7:

As we understand, purchases and buybacks of securities by certain FCPs and SICAVs for use in an employee savings scheme are exempt. We would like confirmation of whether this only concerns securities of the employees' company or securities of other companies.

In addition we would like the regulations to contain a list of entities which are exempt from FTT on any or all shares purchases and set out what evidence the ISP should require from an audit perspective.

Furthermore in this context we are concerned about the position of non-French employee savings schemes. Are these schemes exempt as well? If this is not the case, would this not be a breach of EU law?

Section 7: Bonds exchangeable or convertible into shares

Point 9:

AFME welcomes the clarification that transactions in convertible bonds are exempt from the tax. However, we were also expecting clarity that these transactions would not incur the reporting obligation, as we see no reason for them to do so.
The tax and reporting obligation will of course apply when a person receives shares on conversion of the instrument to equity.

We would also ask the guidance to confirm that where exchangeable/convertible bonds are purchased under the market making exemption or where the shares are used to satisfy or hedge client orders under the market making exemption, converting these bonds into securities will still be within the scope of the market maker exemption?

## Chapter 3: Taxation Procedures

Section 1: Liable for taxation

The guidance states that ISPs are liable for the tax, when executing on behalf of third parties, when trading for own account and when offering underwriting or placement services.

AFME believe this still creates significant uncertainty as to where liability falls, particularly where, for example, there is more than one broker in a chain of transactions. AFME believes that this should be clarified by an insertion into the guidance stating that the **buying ISP** is liable for reporting and payment of the tax.

This matter requires urgent clarification. Given the considerable uncertainty in the market with regard to who is liable for the tax, and to ensure market participants have some certainty before the FTT enters into force on 1 August 2012, AFME is working on a market protocol to address this issue. The protocol will make it clear that it is the buying ISP that is liable for paying and reporting the tax. The protocol will apply to any AFME member or market participant that wishes to sign it.

In order to assist with clarity on who the buying ISP is, please refer to Annex 1 for a worked example.

AFME would like to request that the French administration recognises this protocol and that it will take it into account when conducting audits of participants tax liability.

We will be in contact to provide further information on the protocol in the near future.

Section 2: Tax Base

Point 17:

AFME welcome the useful clarity that has been provided that the consideration attributable to nettable transactions is the net long position multiplied by the average acquisition price of said securities, and that for the exercise of a derivative where physical delivery is taken, the consideration is the exercise price alone. In the case of an equity linked structured note, the consideration is calculated on the price set in the issue price.

We would like the regulations to clarify the basis on which netting should properly be applied (see our examples above). In particular AFME are of the view that there is an error in the example given. The example implies that the purchase of 150 A securities for Client X and the sale of 80 A securities for Client Y can be netted off. This suggests that netting can / should take place across the purchase transaction and the sale transaction from two different clients. For the reasons stated above this is not feasible nor correct given the liability is that of the ISP (although the costs may be borne by the purchaser). AFME would welcome clarification as to whether there is an error in this example.

Based on the scenario given, AFME understands that the liability should be calculated as follows. AFME would welcome clarification that this is the correct method of calculation.

Assumptions:

- Stock A and B are both in scope of the tax
- Own account activities are split between exempt activities and liable ones
- Only liable sells can offset liable buys
- Clients liable sells and buys can be netted
- Own account sells and buys can be netted

Hence, end of day the following could be applied: (The transactions highlighted are liable for the tax in red)

| | | Stock A | | Stock B | |
|---|---|---|---|---|---|
| Trading done by / for | | Buy | Sell | Buy | Sell |
| Own account | Activities not exempt | 500 | 400 | | |
| | Market Making | 1000 | 800 | | |
| Client | Client X | 150 | 150 | | |
| | Client Y | | 80 | 1500 | 1000 |

The netting at the ISP would be as follows:

1. Own account would be liable on 100 shares
2. Client X trading would create a flat position, hence no tax liable
3. Client Y

a) Stock A: he would have been only selling, hence no tax liability either.
b) Stock B: ISP is liable for 500 net buy for client

We would also like to ask for further clarification on netting in OTC trading. We would request confirmation that all activity, irrespective of how settlement occurs, can be combined into one netting set.

We would also like to receive further clarification on which roundings are necessary when calculating the tax base.

Section 3: Eligibility

Point 21:

The paragraph states that "the first purchases subject to the FTT are those resulting from transactions performed from 1 August 2012, provided that said transactions occur before ownership transfer (delivery of security) by less than four business days."

This leaves open the possibility that trades entered into before 1 August which do not settle within four days could be subject to the FTT if they settle after 1 August. This provides considerable complication in building systems. Given the short time available for implementation we suggest that the FTT applies where both the trade and settlement date fall after the 1st August.

**Annex 1**

Illustrative transaction

1. Client sends purchase order to Broker1. Broker1 is not a member of the exchange
2. Broker 1 sends purchase order to Broker 2. Broker 2 is a member of the exchange
3. Broker 2 purchases the shares and takes delivery from the CCP
4. Broker 2 delivers the shares to Broker 1
5. Broker 1 delivers the shares to the client.


Analysis:

1. AFME consider that Broker1 should be liable to report their (exempt) purchase from Broker2, and that Broker1 should be liable to pay and report the client's purchase from Broker1. We consider that Broker2 should be liable to report their (exempt) purchase from the CCP.
2. In order to guard against the possibility that the French authorities expect broker 2 to have reported its own trade with Broker 1 – clarity that the liability falls on the buying ISP will solve this problem
3. Should the authorities approach broker 2 requesting detail of his onward transaction to broker 1 – broker 2 will be able to refer to his indemnity with broker 1.

**AFME Note, 27 June 2012**

# American Depositary Receipts – Issues with implementing a Financial Transaction Tax

## Introduction

American Depositary Receipts ("ADRs") are negotiable US certificates representing ownership of shares in a non-U.S. corporation. ADRs are US securities issued under US securities regulations by US depositary banks and settled following US settlement regulations and procedures. ADRs are quoted and traded in US dollars in the US securities market. ADRs were specifically designed to facilitate the purchase, holding and sale of non-US securities by US investors in order to improve access to US capital markets for non-US companies.

AFME members have raised the following points and concerns in relation to the proposal for charging a Financial Transaction Tax ("FTT") on transfers of ownership of an ADR. Our comments below make reference to certain aspects and issues in relation to the French FTT due to come into force on 1st August 2012.

We would note in the first instance that, following the introduction of Stamp Duty Reserve Tax, the UK Tax Authorities choose to deal with the complexities and legal difficulties which arise in charging SDRT on ADRs by implementing a specific exemption from the charge to SDRT covering all depositary receipts for stocks and shares. This can be found at section 99(6) FA 1986 as follows:

> 99(6) "Chargeable securities" does not include interests in depositary receipts for stocks or shares.

## Concerns raised by Member Firms of AFME

### Potential for multiple charges to FTT

Where a Member Firm delivers shares to a Depositary Bank in return for the issue of an ADR, our understanding, subject to an analysis of the recently issued draft Instruction Fiscale, is that a charge to FTT may arise in respect of the value of the shares delivered. If the ADR itself were subject to FTT then a second charge will arise in respect of the delivery of the ADR to the Member Firm (which may be subject to a market maker exemption), and a third charge will arise when the ADR is transferred to the end client by the Member Firm. The economic cost of these two/three charges to FTT will be passed on by the broker to the end investor and will be a significant disincentive for any US investors wishing to purchase ADRs referencing French securities.

### Transactions processed by a Central Securities Depositary ("CSD") outside of France

ADRs are quoted, traded and settled on the US securities market. Such transactions are not reported to Euroclear France in any form, as such Euroclear France is not in a position to reconcile any FTT paid in relation to transactions on the US securities market. Further there is no mechanism in the US securities market to collect US and/or non-US taxes.

### ISPs not prepared for implementation of an ADR charge

It is clear from the existing wording of the French FTT legislation that assimilated equity securities are liable to FTT only if they are issued by a French Company with a market capitalisation of more than EUR1billion. ADRs are issued by US Depositary Banks, which would appear to fall outside the scope of the existing legislation. Market intermediaries have therefore been implementing processes and procedures to charge and collect FTT on transactions in the relevant French equities. Member firms have noted that significant resource over the last several months has been required to implement FTT collection and charging processes in trading systems related to the French market. With only 1 month until the effective date of the FTT it will be very difficult for Member Firms to implement additional changes to US securities market trading systems with such a short lead time. We understand that no other jurisdiction has currently applied a tax equivalent to FTT to ADR trading (e.g. the UK exemption already noted above), and therefore there is no infrastructure in the US market to implement such a charge. This may lead to significant disruption in the market for ADRs referencing French stocks and shares.

**US Brokers not familiar with legislation**

Member firms have noted that there are several hundred brokers and market intermediaries holding accounts with the US CSD, DTC. Additionally there are many more brokers who settle securities transactions through those direct DTC participant accounts. Given that these market participants operate under US securities law and regulations, many or most of these DTC participants, brokers and market intermediaries will have no way of knowing about the implementation of this French legislation. This is likely to create uncertainty and inconsistency between brokers, and may again lead to significant disruption in the market for ADRs referencing French stocks and shares. In addition, any requirement for US brokers to collect a non-US tax on transactions in US securities is likely to cause significant confusion and to face significant resistance from US brokers in particular based on issues of extraterritoriality.

**Intergovernmental Approach in relation to Tax Legislation**

We note that many European Governments and Representative Bodies have made representations to the US Authorities with regard to the potential conflicts of law arising from the implementation of US Foreign Account Tax Compliance Act ("FATCA ") legislation. We understand that the proposed ADR charge to FTT would apply to transactions agreed in the US under US law in respect of US issued securities. We would therefore suggest that the appropriate mechanism for implementing such an overseas tax charge be addressed in the course of negotiating the Intergovernmental Agreement with the US referred to in the joint statement issued on 7th February 2012 by the US Treasury Department in conjunction with a number of Partner Governments, including France, or by some other bilateral or multilateral arrangement.