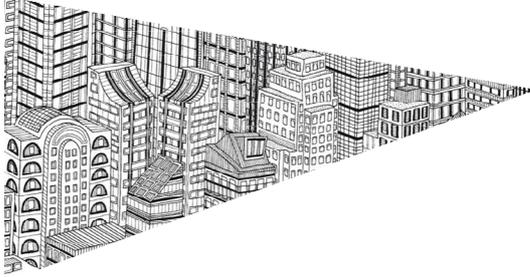


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FTT Alert



EU Financial Transaction Tax and the broker dealer industry

The publication of a draft Directive on a European Financial Transaction Tax (EU FTT) that is proposed to be introduced in 11 Member States (the 'FTT zone') has reinforced the view that what was once considered an impossible tax to implement may actually become a reality.

The EU FTT as drafted would apply across a range of asset classes and geographies and may result in significant behavioral change for broker-dealer clients. Whilst the implications for each broker-dealer will depend on their locations and trading books, we are already seeing market commentary on the impact this may have across the industry. In this Alert we examine some of the key points of the EU FTT and the potential impact on the broker-dealer sector.

The French FTT contains a market-maker exemption. Is there an EU FTT equivalent?

Sadly there is no such exemption in the draft Directive. There is a limited exemption where one financial institution 'acts in the name of or for the account of' another financial institution. It seems reasonably clear that the purpose of this exemption is simply to make the second financial institution liable for the tax rather than the first. It would not appear to apply to "riskless principal" transactions, which would make a broker-dealer and the client liable to the EU FTT.

Will a broker-dealer be liable on both legs of a "riskless principal" transaction?

Potentially, yes. Each leg is likely to be treated as a separate transaction which will be chargeable to EU FTT if the criteria are met. This could give rise to a "cascade effect" whereby multiple charges would bite where a number of brokers act in transferring securities between two counterparties.

Does the EU FTT apply to companies resident outside of the FTT zone?

The tax applies to

- a) transactions entered into by financial institutions established in the FTT Zone,
- b) transactions entered into by financial institutions with a counterparty established in the FTT Zone, and
- c) transactions entered into by financial institutions over financial instruments treated as issued by an FTT Zone issuer.

This final "issuance principle" would mean that two US parties contracting over say French equities could both be subject to the tax. Though this may be tested in the courts and there are no details over how it would be collected, it does mean that a broker-dealer cannot ignore the EU FTT proposal simply because it is not established in the FTT Zone.

What transactions are in scope?

The tax as currently proposed would apply to secondary market transactions in equities, bonds, fund units, as well as repos and stock loans, and entry into derivatives transactions.

Transfers of shares and bonds etc would be taxed at a minimum rate of 10 basis points. Derivatives contracts would be taxed at a minimum rate of 1 basis point on the notional value of the derivative.

Why should broker-dealers focus on EU FTT given limited resources?

The implications of EU FTT for the whole market may drive significant business change in this sector, both from changing customer behaviors to having to address potential risks and costs to the business.

Market commentary is starting to address the impact of the tax on the broker-dealer business model, with some speculation about the possible negative impact on revenues.

How long do I have?

The tax is proposed to come into effect on 1 January 2014. Whilst there is some doubt about whether this is achievable we do not think that waiting for more clarity on this to consider the impact on your business is sensible. With the potential impact on revenues and long lead times for IT change projects, firms should be considering what EU FTT means for them as soon as possible.

Conclusion

It is clear that the EU FTT has the potential to create a range of issues for broker-dealers, both in terms of the impact on their business and the operational challenges of compliance.

Ernst & Young can help your organization understand and plan for this new tax by

- advising on the interpretation of the draft legislation,
- undertaking impact assessments,
- advising on systems and process change,
- supporting change programmes and solution implementation,
- independent assessment of existing FTT and associated change programmes.

Whilst acknowledging the uncertainty on timing, there is a real possibility that EU FTT will be implemented, and we feel that firms should act now to understand the impact, assess their lobbying position and plan for change.

More information

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