PensionsEurope answer to the Spanish consultation on the draft law on the Financial Transaction Tax in Spain

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About PensionsEurope

PensionsEurope represents national associations of pension funds and similar institutions for workplace and other funded pensions. Some members operate purely individual pension schemes. PensionsEurope has **23 member associations** in 18 EU Member States and 3 other European countries[1].

PensionsEurope member organisations cover different types of workplace pensions for over **110 million people.** Through its Member Associations PensionsEurope represents more than **€ 4 trillion of assets** managed for future pension payments. In addition, many members of PensionsEurope also cover personal pensions, which are connected with an employment relation.

PensionsEurope also has **30 Corporate and Supporter Members** which are various service providers and stakeholders that work with IORPs. PensionsEurope has established a **Central & Eastern European Countries Forum (CEEC Forum)** to discuss issues common to pension systems in that region.

PensionsEurope has established a **Multinational Advisory Group (MAG)** which delivers advice on pension issues to PensionsEurope. It provides a collective voice and information sharing for the expertise and opinions of multinationals.

What PensionsEurope stands for

- A regulatory environment encouraging workplace pension membership;
- Ensure that more and more Europeans can benefit from an adequate income in retirement;
- Policies which will enable sufficient contributions and good returns;

Our members offer

- Economies of scale in governance, administration and asset management;
- Risk pooling and often intergenerational risk-sharing;
- Often “not-for-profit” and some/all of the costs are borne by the employer;
- Members of workplace pension schemes often benefit from a contribution paid by the employer;
- Wide-scale coverage due to mandatory participation, sector-wide participation based on collective agreements and soft-compulsion elements such as auto-enrolment;
- Good governance and alignment of interest due to participation of the main stakeholders.

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[1] EU Member States: Austria, Belgium, Bulgaria, Croatia, Estonia, Finland, France, Germany, Hungary, Ireland, Italy, Luxembourg, Netherlands, Portugal, Romania, Spain, Sweden, UK. Non-EU Member States: Iceland, Norway, Switzerland.

Introduction

On 23 October 2018, the Spanish Government published a first draft of the law to implement the Spanish Financial Transactions Tax (FTT). The current draft follows the model adopted by neighbouring countries such as Italy and France, taxing the acquisition of listed equities regardless of the place where the acquisition of the shares takes place and regardless of the residence of the persons or entities involved in the transaction. Although the person responsible for paying the tax will be the financial intermediary involved, it is expected that, if finally implemented, this tax may nevertheless impact trading costs for investors in respect of Spanish equities. The Spanish draft legislation suggests that if this tax is finally implemented in Spain, it will most likely follow a similar shape to equivalent taxes implemented by other EU member States that have decided to unilaterally implement a local FTT.

The tax of 20 basis points (bps) would be applied to any acquisition of shares of Spanish companies admitted to trading on a regulated market that have a market capitalization value of more than 1,000 million euros and the taxpayer would be the financial intermediary. In this way, the so-called emission principle is established as a taxation principle, since it is considered, in the opinion of the regulator, that in this way the risk of relocation of financial intermediaries is minimized in comparison with the residence principle, given that shares of Spanish companies are taxed, regardless of the residence of the financial intermediary or the place where they are traded.

Likewise, according to the preamble, the configuration of the Tax follows the line adopted by neighbouring countries, among which France and Italy are expressly mentioned, with the purpose of contributing to the objective of consolidating public finances.

PensionsEurope has previously expressed its opposition to the establishment of taxes on financial transactions, since such taxes, in their various typologies, end up becoming taxes on savings or pensions, in addition to affecting the efficiency of markets and producing a relocation in the financing flows of the real economy, towards companies established in non-taxed jurisdictions. In December 2015, PensionsEurope published a position paper on FTT: PensionsEurope Position Paper on the negative effects of a Financial Transaction Tax on pension provision. In that paper, published in the context of the *Proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax*, we e.g. stress that (i) the FTT would negatively impact the real economy and pensioners would bear the costs, and (ii) the FTT initiative should be withdrawn or otherwise at least pension funds should be exempt from its scope.

However, regardless of the above considerations and fully respecting the decisions legitimately adopted by the Spanish Government**, PensionsEurope, as the leading voice in the world of European pensions, recalls that it is essential that Pension Funds be exempted from the scope of application of the aforementioned tax**, considering that:

1. It will be the Pension Funds, and ultimately their participants who will bear the costs of the tax as it will be passed on in part or completely by financial intermediaries to end-investors. The tax level of 20 bps by far exceeds execution services fees, which means that is not even possible for financial intermediaries to absorb the costs, should they wish to do so.

2. Quantitative estimates provided by INVERCO show that investments in Spanish listed equity by pension funds over the life span of a participant's accumulation phase may lose by 17% (or by 29,4%, if the lost profit for non-reinvestment of such tax is considered).

3. The proposal is inconsistent with exemptions for pension funds that already exist in the regulation of taxes on financial transactions in France (2012) and Italy (2013).

4. There is a need for more funded pensions to address the challenges of the aging societies in Europe. Tax rules should therefore support pension funds in delivering adequate pensions.

Please find below our detailed comments to the Spanish consultation on the draft law on the FTT in Spain.

The costs of the tax will be passed on to pensioners

Despite the fact that in the theoretical configuration of the tax, the taxpayer is limited only to the financial intermediary that transmits or executes the purchase order, whether acting on behalf of its own or third parties, the reality of the markets will lead to the cost of the tax being passed on to the participants of the pension funds, translating into a lower pension at the time of retirement. Apart from the question of whether financial intermediaries are able to absorb any of the costs while remaining profitable, it is clear that they are unable to absorb a large share of it, simply because due to the fact that it by far exceeds the average brokerage commission[2].

[2] Despite the difficulty of having average data on this issue considering its high sensitivity to the country, type of company and forms of negotiation, it is illustrative to refer to the report commissioned by the Financial Authority of the United Kingdom Securities Markets. (Financial Conduct Authority), entitled *"Transaction costs transparency"* in December 2014, in which page 22 details the average intermediation costs applied to the acquisition of shares, distinguishing according to the market (Europe, USA or emerging economies) and the size of the company (large or small).

Pension funds in fact benefit from economies of scale in procuring investment and brokerage services and therefore are subject to lower fees. This means that any potential capacity for financial intermediaries to cover even a part of the new tax costs is lower for pension funds than for retail clients. Moreover, there is evidence that MiFID II is putting a downward pressure on fees[3]. Together this makes it very likely that the lion share of the new tax, if not all of it, is ultimately born by pension funds and their participants.

The compounded loss of returns over time are significant

Although a tax of 20bps seems small compared other types of tax, the compound effects on the returns of investments by pension funds could be very significant. Although pension funds are long-term investors that do not engage in e.g. high frequency trading, some degree of trading is required as part of professional portfolio management, including rebalancing and shifting asset allocation depending on changing macro-economic circumstance.

Our Spanish member INVERCO estimates in its submission to this consultation that the compounded loss of returns for an equity investment in scope of the tax for an average

Table 3 – recommended measurements and expected values

Equities	Methodology	Data Sources	Sample Value	Comment
Broker commission				
US large cap	Actual	Broker invoice	3 bp	Value depends on asset class and venue
US small cap			8 bp	
EU large cap			5 bp	
EU small cap			6 bp	
Emerging markets			8 bp	

The cost ranges from 3 bps (large American company) to 8 bps (emerging economy company), standing at 5 bps for a large Spanish company, which would be those whose acquisitions of shares would be taxed for the projected tax. Link to the full report: https://www.fca.org.uk/publication/research/transaction-costs-transparency-research.pdf

Other sources value transaction costs in even lower amounts, as is the case, for example, with ITG, according to the news of the Financial Times: *"According to ITG data, UK commissions dropped from 8 basis points in the first quarter of 2017 to 5.8bp a year later. In the rest of Europe, excluding the UK, commissions fell from 7.4bp to 5.2bp"* (Source: Financial Times. June 2nd 2018)

[3] *"Banks and brokers suffer dramatic fall in commissions"*- Investment banks and brokers across Europe have suffered a "dramatic" fall in the fees asset managers pay them to buy and sell shares in a sign of how the recently introduced MiFID II rules have shaken up markets. (Financial Times, June 2nd, 2018). https://www.ft.com/content/5c32d1c8-658c-11e8-90c2-9563a0613e56

"Broker commission down by 20% as MiFID II bites" (IPE, June 6, 2018) https://www.ipe.com/news/regulation/broker-commission-down-by-20-as-mifid-ii-bites-updated/10025091.article

"Broker commissions battered by Mifid II" (Financial News, June 20, 2018) https://www.fnlondon.com/articles/brokers-battered-by-six-months-of-mifid-ii-20180620

participant of a Spanish pension fund is 17% (or by 29,4%, if the lost profit for non-reinvestment of such tax is considered).[4]

The Spanish proposal is inconsistent with existing FTTs in France and Italy

Other European countries have recognized the adverse impact of an FTT on pension savings and therefore chosen to exempt pension funds. Even though the Spanish proposal alleges to aim for international alignment[5], it is clearly inconsistent with the Italian and French FTTs.

Legal references to the Italian and French legislation, are reproduced below:

- **Italy: Article 16, par. 5 of Decree of the Italian Minister of Economy and Finance dated 21 February 2013**: *"5. The tax referred to in paragraphs 491 and 492 shall not apply to pension funds subject to supervision under Directive 2003/41/EC and to compulsory social security institutions, established in the Member States of the European Union and in the States which are parties to the Agreement on the European Economic Area listed in the Decree of the Minister of Economy and Finance issued pursuant to Article 168-bis of TUIR, as well as to other supplementary pension schemes referred to in Legislative Decree No 252 of 5 December 2005. The exemption shall also apply to persons and entities receiving solely the funds referred to in the preceding sentence"*.

- **France**: **Article 5 of the French Amended Financial Bill of 14 March 2012 (transposed in articles 235 ter ZD, 235 ter ZD bis and 235 ter ZD ter of the French Tax Code)**. *"II.- This tax shall not apply to: 7º Acquisitions, that fall within Book Three, Part 3 of the labour Code, employee unit holding mutual funds (FCPE) regulated by articles L. 214-164 and L. 214-165 of the monetary and financial Code and employee shareholding open-ended investment companies (SICAC) ruled by article L. 214-166 of the same code, as well as acquisitions of company shares or its group, within the meaning of articles L3344-1 and L3344-2 of the labour Code, made directly by employees in application of the seventh paragraph of article L3332-2 of this Code."*

[4] See INVERCO submission to this consultation. The number will vary for pension funds from other European countries, for example depending on the length of the accumulation phase (which is likely to be longer for many countries) and the turnover rate of investments.

[5] As stated in its Preamble, *"The configuration of the Tax follows the line adopted by neighboring countries, among which we can mention France and Italy, contributing in this way to a greater coordination of these taxes in the European area"*.

Tax systems should encourage pension savings

According to recent data from the European Commission, published in its *"2018 Ageing Report"*, almost all countries will experience a decline in the public pension benefit ratio (see table below)

Table II.1.18: **Replacement rates in 2016 and 2070 (%)**

	Public pensions: earnings-related			Public pensions: total			All pensions		
	2016	2070	pps. change	2016	2070	pps. change	2016	2070	pps. change
BE	40.2	37.1	-3.1						
BG	35.8	39.2	3.4	29.1	34.0	4.9			
CZ	43.1	41.1	-2.0	32.7	30.6	-2.1			
DK	27.2	27.1	-0.2	38.0	31.4	-6.6	54.6	58.6	4.0
DE	37.8	33.2	-4.6	40.0	33.8	-6.1			
EE	41.2	25.8	-15.4				41.9	40.5	-1.4
IE	36.6	34.4	-2.1	32.8	32.1	-0.7			
EL	68.4	53.7	-14.7	53.8	44.1	-9.7			
ES	78.7	45.0	-33.7	75.0	43.7	-31.3			
FR	45.4	35.6	-9.9	50.7	38.2	-12.5			
HR	30.8	17.0	-13.8	28.9	16.4	-12.5	28.9	21.0	-7.9
IT	64.4	49.8	-14.6						
CY	40.6	50.6	10.0						
LV	51.7	21.7	-30.0				53.5	35.1	-18.4
LT	32.9	17.5	-15.4				33.1	31.8	-1.3
LU	72.9	63.0	-9.9	61.9	56.4	-5.5			
HU	45.5	49.2	3.7	38.4	39.1	0.7			
MT	50.0	47.3	-2.7	47.1	45.5	-1.6			
NL				29.6	28.2	-1.4	53.2	49.5	-3.7
AT	44.4	42.5	-1.9						
PL	61.4	23.0	-38.4	54.8	25.4	-29.4			
PT	68.3	55.9	-12.4	48.6	43.7	-4.9			
RO	30.2	29.5	-0.7	43.1	31.6	-11.5	44.2	39.0	-5.3
SI	34.7	35.7	1.0						
SK	49.0	50.2	1.3				49.0	57.4	8.4
FI	41.3	42.0	0.7	32.6	31.2	-1.4			
SE	32.6	22.3	-10.3	34.3	27.6	-6.7	40.3	33.0	-7.3
UK									
NO				44.7	34.7	-10.0			
EU*	46.3	38.1	-8.3	42.8	35.2	-7.7			
EA	49.9	41.2	-8.7	49.2	41.0	-8.2			
EU27	46.3	38.1	-8.3	42.8	35.2	-7.7			

(1) EL, LT, LU & MT refer to 2017.
(2) LT: The replacement rate would decline in 49 of the 54 years projected. This would require the Government to provide a proposal with necessary counteracting measures that might undue this development and result in higher overall pension expenditure. See comment Table II.I.8.

Source: Ageing report 2018 – European Commission, p.102
https://ec.europa.eu/info/sites/info/files/economy-finance/ip079_en.pdf)

This fact has justified that **many voices** and forums have raised the alarm and awareness on the need to stimulate complementary pensions, so that European citizens will be provided, once retirement has been reached, not only with the diminishing public pension but with several income sources that will help them avoid the risk of poverty at old age.

More recently, the **European Commission** in its impact assessment on the proposal for a pan-European personal pension product (PEPP), reminds that:

- *"An additional public policy challenge is the need to ensure the long-term sufficiency of retirement income from a combination of state, occupational and personal pensions"*
- *"The proposal aims to increase the take-up of personal pensions in the EU. It is consistent with the EU policy of encouraging complementary retirement savings in order to achieve pension adequacy, as set out in the Commission White Paper on pensions in 2012. In line with this, the 2015 Pension Adequacy Report concluded that increased entitlements from*

supplementary (that is, occupational and personal) retirement savings could, alongside other measures, mitigate the impact of lower pensions from public schemes in some Member States. The 2017 Annual Growth Survey reported that broad coverage (i.e. wide availability and increased uptake) of supplementary pensions could play a key role in retirement income provision, in particular where public pensions may be inadequate, and should be promoted by appropriate means, depending on the national context."

Likewise, many other international institutions, as the OECD[6], the ECB[7] or the IMF[8], have called for a greater development of Pension Funds to ensure an adequate income in retirement and face the challenge that ageing population poses on public finances

Tax systems play a vital role in providing incentives for the development of supplementary pensions, which is needed to improve the sustainability of the pension system as a whole and maintain replacement rates. The FTT would make it less attractive for individuals and employers to save for retirement through pension funds. Pension funds in Europe offer economies of scale in governance, administration and asset management and have achieved outstanding annualised average returns for their participants. They should therefore be exempted from the proposed FTT.

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[6] OECD-*"Pensions Outlook"* (2016).

[7] ECB-*"The 2018 Ageing Report: population ageing poses tough fiscal challenges"* (Economic Bulletin Issue 4, 2018)

[8] IMF-Finance & Development-*"Pension shock"*, Vol. 54, No. 2 (June 2017)