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IMF proposes two new bank taxes

Bank levy and financial activities tax planned

The financial services industry is potentially facing two new global taxes proposed by the International Monetary Fund (IMF) to pay for any future bailouts and restructure incentives within the sector. The Financial Stability Charge (FSC) is a liability-based mechanism that will hit those with the largest balance sheets hardest, providing a disincentive to become 'too large to fail' although it is thought the levy would initially be introduced at a flat rate to ease its debut. The Financial Activities Tax (FAT) is targeted at profits and pay. Both ideas are currently before the G20 group of world leaders prior to their meeting in Toronto, Canada, on 26-27 June, so could conceivably become law then although no doubt some arguments lie ahead. There will be a G8 meeting on 25-26 June preceding it.

The FSC and FAT taxes proposed by the IMF have dismayed international banks, who are still seeking to hoard money to repair capital bases after the banking crisis and to maintain bonus pools for fear of staff going elsewhere. The new taxes were however inevitable in the wake of public anger following the public bailouts of the sector, and indeed the Financial Stability Charge, first mooted last year at the London G20, is specifically intended to avoid any taxpayer money ever having to be used to rescue stricken banks again by establishing a fund. The latter FAT tax, which is favoured by the IMF instead of the long rumoured Tobin tax, was more of a surprise to the industry and seeks to restructure the sector more fundamentally as the higher the profits and pay attained the larger the taxes will eventually be. The idea is to disincentive the huge scaling up of international conglomerate banks with vast profits that support risky investment banking practices and lead to the huge pay packets that have sparked such public rage. The short-term pursuit of a fast buck to obtain a bonus will also suffer if the idea is adopted by the G20 in June.

If the FAT tax, which would effectively act as a value added tax on banking, were imposed at a rate of just two per cent in the UK it would raise billions of pounds. Of course, international agreement to establish a percentage for the 'sales tax' is necessary to avoid the possibility of regulatory arbitrage but with VAT at 17.5 per cent in the UK and generally in double figures everywhere a low rate of two percentage points or so does seem feasible.

In regard to the FSC, the IMF report says that Britain may have to consider putting aside two to four per cent of its GDP, equivalent to £30-60 billion raised via the bank levy, into its fund to

cover its potential future liabilities were another bailout ever needed and this may be necessary over a number of years. Every country would need to



establish a fund commensurate with the size of its financial sector but on an agreed international percentage, although with Britain's large FS industry this could be a problem due to the country's over-reliance on the sector.

The bank levy put forward by the Washington-based institution also covers all financial institutions, including hedge funds and insurers, not just global banks. This has understandably attracted considerable ire, with the Association of British Insurers particularly annoyed. "It is important the financial system is made safe but it needs measures that are focused where the risks exist," says Kerrie Kelly, director general, of the ABI. "Insurers were not a source of failure and their business model means they are not subject to the types of credit and liquidity risks that destroyed so many banks. Any inclusion of insurers within the scope of levies designed to impact banks is essentially inappropriate and not justified."

The IMF counters that it must include all financial institutions under its plans, otherwise banks could simply reclassify certain activities, perhaps as insurance products such as credit default swaps (CDSs), to avoid tax.

Bob Lyddon, managing director of the IBOS international treasury association, which includes RBS, Santander, Nordea, KBC, UniCredit and others among its membership, argues more straightforwardly that the proposed new taxes are simply a bad idea. "They will have the effect of forcing banks to close their more marginal operations overseas, which rely on more risky activities like venture capital or proprietary trading, and concentrate on their home markets instead [leading to less competition and a return to the 1980s where corporates needed numerous banking arrangements in separate countries]," he says.

The IMF proposals would certainly shake things up if they were introduced and hit profitability, with the down the line consequences for IT spend and technology innovation investment from the financial services sector. The G20 meeting in June will be even more eagerly awaited now than it already has been.

• For more on post-crisis regulation please see our liquidity risk management/Basel III feature on Pg.28.