Editorial

Prevent Fund Investors from being burdened by the Financial Transaction Tax

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On September 28th, 2011, the European Commission presented its draft law for the introduction of a financial transaction tax (FTT), scheduled to come into force on January 1st, 2014. The way this tax is being planned, it would be counter-productive: in particular, it would burden fund investors. This is not justified in view of the rationale and objectives of introducing this tax.

The plan is to levy the FTT on all financial transactions in securities and derivatives executed by financial institutions, provided that at least one of the institutions involved is domiciled within the EU. The concept of "financial institutions" includes banks, investment companies and pension funds (amongst other institutions). A "financial transaction" may be the purchase or sale of a financial instrument. The tax therefore affects buyers and sellers of instruments such as equities and other securities, securities lending and repurchase agreements, as well as derivatives and structured products.

The key question is whether the FTT, in the form that is currently being proposed, really taxes those market players it is designed to tax? I do not think so. At the end of the day, despite all good intentions, it will hit retail investors. This is because investment funds – whose separate fund assets are held by retail investors – are planned to be explicitly covered by the FTT in the future.

In the interest of these investors, and as a trustee of the money they have entrusted us with, I wish to very clearly state our strong objection to a financial transaction tax being levied on investment funds, and hence, on retail investors' assets. The financial crisis was not caused by investment funds, nor by their investors. The way it has been proposed, the FTT would not achieve its stated political objective of hitting those who triggered the financial crisis – speculative players on the financial markets. Instead, it would hit small savers putting aside 50EUR a month to invest in a fund for building wealth or saving for retirement. The FTT would be a hidden tax increase, whereby politicians are oblivious to the fact that the capital saved in investment funds belongs to citizens: it is not owned by investment companies – financial institutions the tax is designed to burden. In fact, investors would be hit several times: first, when buying fund units; second, when the fund purchases securities; and (potentially) a third time, where the manager of a fund of funds is buying units in another fund. And of course, the same would happen when selling: the state would be charging up to six times, at the expense of returns available to small savers. As a consequence, the FTT would work as a penalty against active fund management since it would increase transaction costs at the level of each individual fund. In contrast, passively-managed products (which are structured once, with portfolio rebalancing on rare occasions only) would in fact be given preference – a contradiction of the regulatory objectives otherwise pursued by the EU Commission. The FTT would in effect penalize active investment strategies, which are the more important in an environment characterized by increasing volatility.

What will be the cost for investors, specifically? The tax rate is expected to be a minimum 0.1% of the purchase price for securities, and 0.01% of the nominal value for derivatives. Depending upon the type of fund concerned, this would diminish investors' returns by an average 0.30% to 0.55% p.a. at least.

To render this situation completely absurd, legislators are once again proposing to grant preference to assurance contracts over fund investments for private retirement provisions. This would distort competition; it is both politically unacceptable and unjustified – a short-winded and populist measure.

In summary, I would therefore characterize the planned FTT as yet another typical example for a regulatory initiative that was launched with good intentions, but badly executed. FTT will hit small savers and taxpayers, but not those who caused the financial crisis. In my view, therefore, the FTT must not be levied on investment funds and their investors.