



member states. In February 2013, the European Commission published its detailed proposal of the FTT under the aegis of an enhanced cooperation agreement.³

The proposal closely mirrors that of the September 2011 original. Transactions in securities will be taxed at 0.1% of their notional value, transactions in derivatives at 0.01% of their notional value. Financial institutions will be captured by the tax with a few exemptions. Non-financial institutions are not directly liable to pay the FTT. However, financial entities will be liable to pay when undertaking transactions with non-financial entities. Any trade involving a counterparty established in, or a financial instrument issued in a participating member state will be captured.

The FTT would have wide ranging implications for the FX industry. While FX spot transactions will not be taxed, forwards, swaps, NDFs and options may be taxed. These products currently make up nearly two thirds of FX market turnover.⁴ Transactions in these products would be taxed at the rate for derivatives. While the FTT is only being introduced in 11 member states, the extra-territorial impact of the FTT under the current proposal is wide, and would have a significant effect on all major global trading centres of foreign exchange.

The European Commission's proposal still has some way to go before it is agreed, let alone implemented. The eleven member states will continue to debate the proposal until it achieves unanimous agreement. In recent weeks there has been speculation over the future of the FTT after participating member states wrote to the European Commission for clarification on key details and EC officials acknowledged that implementation by the target date was unlikely.⁵

In its current form, the FTT would dramatically increase transaction costs for FX markets with the likely result of effectively closing the non-spot FX market in Europe. Indirect impacts would include changes to market structure, shifts in the behaviour of investors and hedgers and the relocation of global liquidity hubs.

In research carried out for the Global FX Division of the Global Financial Markets Association, Oliver Wyman estimated that the FTT would result in price increases of up to 1790% at the short end of the FX swap market (1 week EUR/USD swap) and 270% at the long end (6 month EUR/USD swap).⁶ Looking at the average transaction costs for FX swaps in recent years, the impact of the FTT would be comparable to the rise in transaction costs around the Lehman liquidity crisis.

These costs would be magnified further by the FX market's high turnover and deal velocity. Many market participants roll shorter-dated FX forwards and swaps for liquidity management, asset-liability matching and short-term funding purposes. Each transaction would be captured by the FTT, while the impact on short-dated instruments is far higher than long-dated instruments.

The effective rate of the FTT would also be higher than the headline rate. This is because the FTT would apply to every step and, where applicable, leg of a transaction. By definition, swaps and forwards trade with multiple legs and often

³ The Enhanced Cooperation procedure allows member states to proceed with integration within the structures of the EU but without the participation of all member states.

⁴ BIS Triennial FX Survey, September 2010

⁵ On 30th May 2013 spokesperson for EC Tax and Customs Algirdas Semeta acknowledged that implementation by the 2014 target date was 'unlikely.'

⁶ Proposed EU Commission Financial Transaction Tax Impact Analysis on Foreign Exchange Markets, Oliver Wyman January 2012