The International Securities Lending Association
4 Lombard Street
London EC3V 9AA

Securities Lending and the Proposed EU Financial Transactions Tax

Imposing a Financial Transaction Tax ("FTT") on securities lending will raise negligible tax receipts for the EU. To the extent that the tax is not also applied in the US, Asia or the Middle East, securities lending activity undertaken by a party established in a Member State will be replaced by a party established within a non-Member State. This will shift revenues of EUR 1bn from long term established Member State resident or operating investors to those located in non-Member States.

Background to Securities Lending

Securities lending is used by a wide range of investors and intermediaries inside and outside of the EU. Its use supports greater market settlement efficiency, market making activities and a wide array of trading strategies that provide liquidity to the securities markets and its participants. Long term investors, such as pension funds, collective investment schemes and insurance companies, generate incremental revenues from engaging in securities lending. These returns help to reduce the costs of providing pensions and long term savings to investors. All market participants benefit from the reduction in trading costs and bid/offer spreads that securities lending provides.

These benefits of securities lending have been widely recognised by regulators around the world, by national and supranational organisations and by academics. Index providers, such as FTSE International, include the existence of a well-functioning securities lending market in their criteria for a country's inclusion in their developed market indices. Recognising its broader benefits, governments around the world have provided exemptions and reliefs for securities lending transactions as well as the transfer of associated collateral, from locally imposed stamp or other similar transfer taxes, VAT, and capital gains tax charges.

The global securities lending market is worth approximately EUR 1.1trn and from this market long term investors in the EU generate over EUR1bn of gross revenues. The attached note produced by DataExplorers, a leading data provider for the securities lending markets globally, provides more detail.

Securities lending is a low risk – low return business for the investors that participate. Information from DataExplorers shows that loans of UK and internationally issued securities generate average annualised returns of 34bps per annum. However when assessed on a per transaction basis, average returns are estimated to be just 12.79 bps. From this return, the investor must pay the costs of running their securities lending programme which can be between 20 and 30% of the return leaving a net return of less than 10 bps per transaction globally.

The securities lending market is a truly global one. The major borrowers of securities are global investment banking businesses with operations around the world. Lenders of securities are large institutional investors and funds from North America, Europe, the Middle East and Asia. As can be seen from the attached document, global supply of securities from all investors active in the market is EUR 9.2trn and European investors represent approximately 22% of this. Given that total global borrowing demand is just EUR1.1trn, European lender activity could easily be replaced by other investors outside of the EU.

In summary, imposing an FTT on securities lending activities would result in the vast majority of loans becoming unprofitable for Member State resident or operating lenders. Furthermore given the existence of ready supply outside of the EU and the global mobility of borrowers, the most likely outcome of an FTT on securities lending and the transfer of associated collateral, will be a wholesale transfer of this activity outside of the Member State jurisdictions to non-Member States where no form of FTT is currently levied.

As a result, we estimate that not only any tax revenue generated from securities lending activity will be negligible but also that Member State resident or operating long term investors will lose an estimated EUR 1bn in annual gross revenues to investors resident or operating outside of the EU.

October 2011