ISLA™

The International Securities Lending Association
6th Floor
1 George Yard
London
EC3V 9DF

Stamp Taxes on Shares Policy Team
HM Revenue and Customs
Room 3/63
100 Parliament Street
London
SW1A 2BQ

Sent via email to: sts.consultation@hmrc.gov.uk

22nd June 2023

Dear Sir/Dear Madam,

Response to the Consultation: Stamp Taxes on Shares modernisation, published 27 April 2023

The International Securities Lending Association (**ISLA**) welcomes the opportunity to respond to this Consultation and to contribute towards future policy making in this area.

We support the principle of a single tax on UK securities, and we welcome the opportunity to simplify and modernise the legislation so that businesses can better understand and comply with a single modern, simplified and digital tax.

However, we are responding solely in relation to *Stock lending and repurchase relief* and Question 37 of the Consultation where we are concerned this opportunity is being missed by current government proposals.

About ISLA

ISLA is a non-profit industry association (**EU Transparency No. 575 888 466 70)** representing the common interests of Securities Lending and financing market participants across Europe, the Middle East and Africa. Its geographically diverse membership of over 190 firms includes a broad range of institutional investors, asset managers, custodial banks, prime brokers and service providers. Working closely with the industry, as well as national, regional, and global regulators and policy makers, ISLA advocates for, amongst other things, the importance of securities lending to the broader financial services industry. It supports both the Global Master Securities Lending Agreement (**GMSLA**) legal framework, as well as the periodical enforceability and security enforcement across global jurisdictions.

Q37: Is there any reasons why you think the government should change the geographical application of stock lending and repo relief that it may not be aware of?

We support the responses of others, including the Association of Financial Markets in Europe (AFME), that seek an extension of the geographical scope of the stock lending relief contained in s.88AA(2A)[1] to regulated brokers and lending agents in countries which have a double tax treaty with the UK under a new single stamp tax on shares.

We note the comment in the Consultation that "the government does not propose to widen the geographical application of [stock lending and repo] relief" on the grounds ostensibly that "a strong case has [not] been made for doing this".

This response sets out the case for doing so, the benefits for the securities lending industry and the enhanced liquidity of listed UK shares, whilst also outlining why in our view little or no stamp tax is at risk by broadening the geographical application of the relief from its historic limits. We explain why the UK takes an approach which no other country takes in respect to applying a geographic limit on securities lending transactions.

We also encourage government to use modernisation to fix the defects inherent in the alternative (pre-MiFID) relief in s.88AA(3) Finance Act 1986. This relief can be difficult in practice to obtain as drafted and relies heavily on HMRC published practice from nearly a decade ago, as described below.

About Securities Lending

Securities Lending and borrowing is fundamental to the well-functioning of capital markets for a multitude of reasons including, providing market participants with a source of securities to facilitate efficient trade settlement, access to collateral and providing a vital source of liquidity, which are essential for delivering an efficient single capital market, as set out in the EU's Capital Markets Union Action Plan. Liquidity can be defined as the ease with which an asset can be sold or bought and is commonly proxied for, by the bid-ask spread. In the case of illiquid markets, bid-ask spreads are wider and lead to more costly trades.

By creating access to securities in the secondary market, Securities Lending has the effect of increasing the total supply of securities available.

Securities Lending is instrumental (but not limited) to the following:

- The provision of secondary market liquidity of securities;
- Increasing long-term investor returns on security portfolios;
- Raising finance against long term investments;
- Meeting prudential regulatory obligations such as the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) under the Capital Requirements Regulation, helping to both manage and reduce systemic risk;
- Sourcing and delivering collateral for regulatory margin requirements
- Facilitating Market Making activities of financial institutions, giving them ready access to securities that they may not be holding; market makers who are continuously looking for

[1] All statutory references are to Finance Act 1986 unless otherwise stated.

securities to buy and sell can enhance market liquidity. Their ability to borrow securities on a continuous and regular basis, helps them to meet customer demand for securities
- Facilitating settlement obligations and increasing operational efficiency
- Enabling short selling which improves price discovery for institutional investors including long holders and improves market efficiency whilst mitigating price volatility. Price discovery is a critical mechanism in financial markets where the proper price of an asset is established following the incorporation of all available public information.

For a securities ***Lender***, it is an opportunity for institutional investors to generate additional low risk revenues from their long-term investments and use their long-term assets to raise liquidity when required (e.g., lend their securities to raise cash or government bonds).

For a securities ***Borrower*** such as a regulated broker dealer or bank, it provides a mechanism to cover short positions as a result of market making activity, raise eligible assets to meet regulatory ratios or collateral requirements and manage the funding of its balance sheet.

How Securities Lending works in practice

Securities Lending is deemed a low-risk activity, as loaned securities are offset with collateral, where the value of the collateral typically exceeds that of the loaned securities and transactions are marked-to-market on a daily basis to ensure full collateralisation at all times. The majority of large institutional investors, such as pension funds, UCITS, Central Banks and Sovereign Wealth Funds participate in securities lending, by lending assets for which they generate an additional portfolio income, benefitting investors, including retail. A case in point, is the Bank of England, European Central Bank and other Euro system Central Banks, who are active users of Securities Lending as part of their market operation transactions ensuring market liquidity for example, through Public Sector Purchase Programs (**PSPP**).

Securities Lending involves the lending of securities against collateral (cash or other securities) and is typically conducted by a lending agent, for example a custodial bank, a third-party lender, or an in-house lending affiliate, to a borrower for an agreed fee.

Under industry standard Securities Lending agreements such as the GMSLA[2]:

- Legal ownership of the securities transfers from the Lender to the Borrower.
- The Borrower posts collateral in the form of securities (equities/bonds) or cash to the Lender for the duration of the loan.
- The Lender and the Borrower have the right to terminate the loan at any time for any open transaction.
- Upon termination, the Borrower will return equivalent securities to the Lender and the Lender will simultaneously return cash or equivalent collateral to the Borrower.
- If the term of the loan extends over an income record date, the Borrower will pay a contractual payment to the Lender that is equivalent to the amount the Lender would have received, assuming the Lender had retained the securities on record date. This is called a manufactured dividend.

[2] https://www.islaemea.org/gmsla-title-transfer/

Background to current reliefs

It is helpful to outline the current reliefs from stamp duty and SDRT in respect of securities lending transactions. Two reliefs are currently available where listed and regularly traded UK shares are loaned and then returned:

- S.88AA(2A): this relief was introduced in 2007 in order to comply with the EU Markets in Financial Instruments Directive[3] (**MiFID**). Post-Brexit this applies where a party to the loan in a principal capacity, as either borrower or lender, has (broadly) permission under the Financial Services and Markets Act 2000 (for UK participants) or from their national EEA regulator, to carry out MiFID investment business services (on own or client account).
- S.88AA(3) applied pre-2007 and continues to apply today. This applies where the agreement to transfer UK shares is effected on a regulated market, multilateral trading facility (**MTF**) or recognised foreign exchange. S.88AA(5) stipulates that an agreement is “effected on” such a trading venue if (and only if) it is subject to the rules of that market, MTF or exchange and is reported to that market, MTF or exchange in accordance with its rules.

Why the relief pursuant to s.88AA(2A) should be extended beyond UK and EU/EEA parties only

How the current law and government proposal restricts liquidity of UK shares

The current relief in s.88AA(2A) potentially restricts the liquidity of UK shares in the hands of brokers outside the UK/EEA, such as in the US, Australia, Switzerland, Hong Kong or Singapore. It is more difficult for investment funds and pension funds to lend UK securities than other securities due to the geographical restriction in s.88AA(2A), which results in securities issued by companies in other countries being more readily available for lending or by way of collateral. Thus, for investors, the economic returns available on UK shares are potentially less (if no securities lending fees are available) than other securities, which may encourage investors to invest in other countries’ stock markets and may also artificially depress the value of UK shares.

In the event of operational failure to deliver UK shares for whatever reason, it is harder for financial markets participants without a direct relationship with a UK or EU broker to borrow UK shares to effect delivery. It is not always possible for parties to have a direct relationship with a broker in the UK or EU. This could be due to local securities laws, which we understand to be generally the case in the US, for example. The current geographical discrimination between regulated brokers can therefore have the effect of making it more difficult for brokers outside the UK/EEA rapidly to resolve operational failures and deliver the customers shares as ordered.

Why little or no tax is expected to be at risk

Given the marginal costs (1% for both the outward and return leg combined), which generally would dwarf any commercial profit involved for lenders (or their agents), brokers and borrowers, in the absence of a clearly available relief UK shares may simply not be loaned or provided by way of collateral. Extending the geographical application would not mean that taxable transactions were replaced by exempt transactions; rather, transactions which we believe currently do not take place at

[3] 2004/39/EC

all could take place without triggering the new stamp tax on shares. Net-net the UK's tax take is the same.

Historical anomaly and arbitrary distinction

The relief in s.88AA(2A) is therefore a historical anomaly that arose out of the UK's membership of the European Union and the need to adhere to EU Directives, in this case MiFID. Following the UK's exit from the EU, we struggle to see the government's policy rationale to restrict this relief to UK and EU parties only, rather than to regulated entities globally.

In our view, it makes no sense and is inconsistent with a so-called "modernisation" of the stamp taxes code to restrict a commercial relief to certain parties due to the legal situation in 2007 (which no longer applies) rather than sensibly assessing the commercial landscape with respect to UK shares and who should be able to benefit from the relief in 2023.

Comparison with stock lending relief in other stamp taxes and financial transaction taxes

Most countries which impose a stamp tax or financial transaction tax on share transfers recognise that an exemption or relief should apply to temporary transfers of title, such as stock loans, repos or the transfer of title to securities by way of collateral (although the latter may be out of scope for some taxes).

Each country which provides such an exemption or relief imposes conditions in order to ensure that the securities are in fact returned pursuant to the terms of the loan or repo. However, only the UK imposes conditions relating to the geographical location of the parties involved. The following matrix summarises certain other countries which, like the UK, impose a stamp duty or financial transaction tax on transfers of securities and what is required in order to benefit from a relief on stock lending transactions:

Country	**Tax**	**Conditions for relief**	**Geographical limitation of relief?**
France	Financial transaction tax	Self-assess that the transfer was by way of loan on monthly return	No
Hong Kong	Stamp duty	Registration of stock lending agreement and 6 monthly reporting	No
Ireland	Stamp duty	Return securities within a year	No
Italy	Financial transaction tax	Self-assess that the transfer was by way of loan on annual return	No
South Africa	Securities transfer tax	Return securities within a year	No
Spain	Financial transaction tax	Self-assess that the transfer was by way of loan on monthly return	No

UK	Currently: stamp duty and SDRT Proposed: new stamp tax on shares		Yes To be determined

The UK is therefore alone in requiring parties to be regulated by the FCA or an EU/EEA regulatory authority as opposed to requiring objective conditions to be satisfied.

Why s.88AA(3) is not fit for purpose as currently drafted

We also urge government to ensure that the rewrite of s.88AA(3) is clear and accessible to borrowers and lenders globally. Where a lending agent, such as a global custodian bank, acts on behalf of a lender in an agency capacity in lending its securities to a borrower, the agent is not able to benefit from s.88AA(2A), which only applies where parties act in a principal capacity. It may well be the case that neither the lender nor the borrower is a regulated broker. This relief is therefore separate and independent from the relief in s.88AA(2A) and was intentionally left in place when s.88AA(2A) was added in 2007.

An improved s.88AA(3) relief could either be entirely self-assessed or based upon more prescriptive conditions, such as where the transactions are reported through Euroclear UK & International (also known as CREST) as being loans or returns of loans. This creates a clear and automated audit trail that in all situations where stock lending relief is asserted the shares are in fact returned.

We believe that this is how HMRC intend the relief in s.88AA(3) to work. The relief is not well designed or drafted, though. The problem is that it requires stock lending transactions to be effected on a regulated market, multilateral trading facility (MTF) or recognised foreign exchange by virtue of being subject to the rules that market, MTF or exchange and reported to that market, MTF or exchange. In fact, as we understand the situation, securities loans, repos and transfers of collateral are specifically not required to be reported to the market, MTF or exchange in question at all due to the transfer being merely temporary rather than an outright sale in the market.

This poses problems for market participants who are not in the UK/EEA but seek to benefit from statutory relief. Examples include any banking/brokerage group of companies where the market-facing entity is not in the UK/EEA or investment funds or pension funds who do not have a relationship with a broker in the UK/EEA but would like to generate additional income by lending out their UK shares.

HMRC guidance[4] was issued in an attempt to clarify the situation. That guidance was originally, we understand, published in 2007 and was re-published in 2014. It ostensibly applies to shares which are not traded on a regulated market, although given that intermediary relief and securities lending relief only apply to regularly traded securities, this is presumably an error. The guidance includes the words:

[4] https://www.gov.uk/government/publications/sd-and-sdrt-intermediary-and-stock-lending-reliefs-fa-2007/stamp-duty-and-stamp-duty-reserve-tax-intermediary-and-stock-lending-reliefs-fa-2007

"HMRC understands that the rules of some MTFs/exchanges may, following the implementation of the Directive on Markets in Financial Instruments (MiFID), no longer contain a requirement to report a transaction to the MTF/exchange. This means that members of those organisations are strictly unable to fulfil the requirement in the legislation that transactions must be reported to the MTF/exchange.

HMRC recognises that a strict reading of the legislation would result in… stock lending relief not being granted. It therefore intends to amend the legislation to address this at the earliest opportunity. In the meantime, HMRC won't refuse relief where the rules of an MTF/exchange are either silent about the need to report transactions or specifically state that a report isn't required. Nor will stock lending relief be denied if the stock loan is reported to CREST for settlement and the Trade System of Origin (TSO) field completed in accordance with the rules of the market/MTF/exchange."

While it is therefore, technically possible, in some cases subject to HMRC agreement with internal processes and controls, to report the stock loan through CREST, the fact that the legislation is unclear and the HMRC published clarification is dated may deter market participants from seeking to benefit from the relief in s.88AA(3).

Further, HMRC's published guidance requires taxpayers to populate the Trade System of Origin (**TSO**) of the stock loan or repo as being the London Stock Exchange (or other MTF or exchange) even where it was in fact OTC. We understand that the UK's implementation of the Securities Financing Transactions Regulation (**UK SFTR**), which applies to securities lending transactions such as those described in this response, requires the trading venue to be stipulated in the report. As such, the current HMRC approach to s.88AA(3) requires taxpayers to inform one regulator (the Financial Conduct Authority) that the trade was OTC for UK SFTR purposes and another regulator (HMRC) that the transaction was on exchange. This contradiction may also discourage market participants from using this relief.

We also note the commitment in HMRC's guidance to "amend the legislation to address this at the earliest opportunity". Even if the opportunity simply has not arisen before now, surely this modernisation is such an opportunity.

What if the proposal for a single stamp tax on shares does not proceed?

Finally, in the event that the proposal to modernise and simplify the current parallel regime of stamp duty and SDRT is not replaced by a new single stamp tax on shares, we would urge government to make the changes described above in relation to the existing legislation in ss.88AA(2A) and (3) for the reasons set out above.

ISLA appreciates the opportunity to respond through this consultation. If you would like further information on any of the above points, please do not hesitate to contact us.

Yours faithfully

Farrah Mahmood

Director of Regulatory Affairs
Email: **farrah.mahmood@islaemea.org**

On behalf of
The International Securities Lending Association