efama
European Fund and Asset Management Association

Potential Impact of the FTT on the UCITS Industry

1. Direct Cost of the FTT

The Financial Transactions Tax (FTT) proposed by the European Commission will be applied to the value of the sales and redemptions of UCITS shares/units as well as to the UCITS portfolio transactions:

- Assuming that the FTT had been applied at the start of 2011, all other things being equal, the tax would have levied **EUR 15 billion on the sales and redemptions of UCITS shares/units**. This figure can be derived by applying the proposed FTT tax rate of 0.1% to the total sales and redemptions of UCITS in 2011.[1]

- The potential impact of the proposed FTT at the portfolio level would depend on the turnover ratio of UCITS portfolios. Statistics available for a large group of UCITS show an average turnover ratio of 0.9 for long-term UCITS (UCITS excluding money market funds (MMFs)) and 6.5 for MMFs.[2] On that basis, it can be calculated that the FTT would have levied **EUR 23 billion on the UCITS portfolio transactions** in 2011, all other things being equal.

- It follows that in our central scenario, the total impact of the FTT would have reached **EUR 38 billion** in 2011. This estimation would be reduced to EUR 34 billion in a scenario where the average turnover ratio was reduced to 0.5 for long-term UCITS and to 6.0 for MMFs. It would be increased to EUR 45 billion if the average turnover ratio was increased to 1.5 for long-term UCITS and to 7.0 for MMFs.

These results are summarized in Table 1 below. The key assumptions and results of the calculation for the central scenario are presented in Annex 1.

Table 1 highlights the fact that the share of MMFs in the total FTT revenue would reach 67% in our central scenario. MMFs would be severely hit for two reasons:

- First, investors use these funds to manage their cash and invest and disinvest continuously. Our data show that the total value of sales and redemptions of MMFs shares/units reached EUR 11.2 trillion in 2011. This means that investors in MMFs would have paid a total FTT of EUR 11.2 billion in 2011 assuming they would have continued using MMFs in the same way as before.

[1] Sales and redemptions data are collected by EFAMA from its member associations.
[2] A turnover ratio of 1 means that a fund's holdings are replaced with other holdings in a given year on average.

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- Second, the weighted average maturity of MMFs is very short: 60 days maximum for short-term MMFs and 6 months maximum for MMFs. Thus, the portfolio turnover of these funds is very high. This explains why the FTT tax levied on the portfolio transactions of MMFs would total EUR 14.5 billion in our central scenario.[3]

Table 1 also shows the FTT annual cost relating to portfolio transactions. In the central scenario, the average cost is 15 bps for equity funds, 20 bps for bond funds, 18 bps for balanced funds and 130 bps for money market funds.

Table 1: Estimation of the Impact of the FTT on the UCITS Industry

	Annual Portfolio Turnover Ratio		
	Lower turnover scenario	**Central scenario**	**Higher turnover scenario**
Long Term UCITS	0.5	0.9	1.5
MMF	6.0	6.5	7.0
	Estimated Revenue from the FTT on UCITS (EUR billions)		
	Lower turnover scenario	**Central scenario**	**Higher turnover scenario**
FTT on sales/redemptions of UCITS	15.5	15.5	15.5
FTT on UCITS portfolio transactions	18.1	23.0	29.7
Total FTT revenue on UCITS	**33.5**	**38.5**	**45.2**
of which FTT on MMF	24.5	25.7	26.7
	Annual Cost of the FTT in Basis Points (1)		
	Lower turnover scenario	**Central scenario**	**Higher turnover scenario**
Equity Funds	10	15	30
Bond Funds	10	20	30
Balanced Funds	10	18	30
MMFs	120	130	140

(1) FTT cost on portfolio transactions (excluding the impact of the FTT on the sales and redemptions of UCITS units/shares.

[3] For more details, see Table A1 in Annex 1.

2. Cost of the FTT on Long-Term Savings

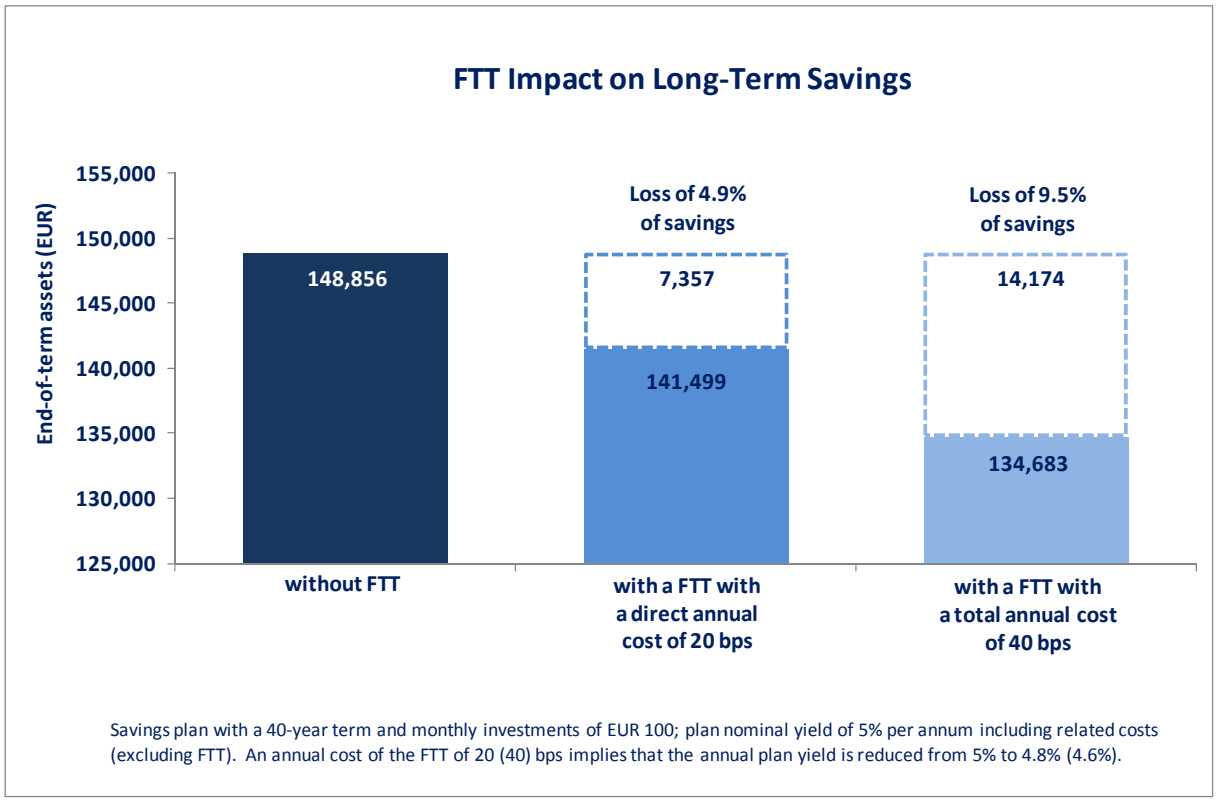
Some of EFAMA corporate members have calculated that the proposed FTT would have indirect market costs through increased spread levels that would reduce investment performance by an additional 10-15 bps per annum over and above the direct cost shown in the central scenario. The FTT would also make securities lending unviable in most circumstances and thus reduce expected return for investors.

Furthermore this analysis does not attempt to quantify the effect of the FTT on derivatives transactions. However, as the European Commission's own impact assessment acknowledges, derivatives transactions will be severely affected by the FTT and this will have a significant impact on the returns of UCITS funds, and the ability of funds to manage risk through hedging.

The chart below summarizes the impact of the FTT for an individual saving EUR 100 per month for 40 years in a long-term saving plan, taking the following assumptions:

- A average nominal yield on the savings plan of 5% per annum (including plan-related costs)
- An annual direct cost of the FTT of 20 bps
- An annual indirect cost of the FTT of 20 bps

The chart shows that without FTT, the accumulated saving would total EUR 148,856 after 40 years, i.e. EUR 48,000 in contributions and EUR 100,856 in investment return. **The capital loss due to the total cost of the FTT would amount to EUR 14,174, or 9.5% of the final payout.**



Savings plan with a 40-year term and monthly investments of EUR 100; plan nominal yield of 5% per annum including related costs (excluding FTT). An annual cost of the FTT of 20 (40) bps implies that the annual plan yield is reduced from 5% to 4.8% (4.6%).

This calculation does not take into account the "cascade" effect, which could lead to a multiplication of the effective tax burden given that the tax applies to all stages of the settlement process.

3. EFAMA's Key Concerns

Our calculations of the estimated FTT-take on the UCITS industry, which ranges from EUR 34 billion to EUR 45 billion , show that the potential **impact of the FTT** would be significantly bigger than assumed by the European Commission. Taking into account the impact of the FTT on the value of derivatives transactions, the FTT-take would be even higher, in particular because many UCITS seek to remove currency exposure through hedging.

Investors in UCITS would pay a total of EUR 15 billion in FTT tax payments for their subscriptions and redemptions. This would reduce considerably the competitive advantage of UCITS.

The FFT would put the **MMF** industry out of business. The cost of the FTT relating to the turnover of MMF portfolio would reduce the annual investment performance of MMFs by at least 1%. Assuming that the FTT on subscriptions and redemptions of MMF shares/units would be spread evenly on all investors, the FTT would reduce the performance of MMFs by an additional 1% per year, which would make them unviable.

The FTT would also reduce the attractiveness of savings in equity, bond and balanced funds, thereby reducing an important source of **long-term financing** for the European economy.

Ordinary citizens would also be victims of the FTT. A person investing EUR 100 per month during 40 years in a long-term UCITS would see the value of their savings reduced by EUR 14,174, or 9.5%. This estimate assumes the FTT would reduce the UCITS's annual performance by 0.4 percent. Taking into account the so-called "cascade effect", the effective impact would be significantly higher.

The impact of the FTT would cause retail and institutional investors to switch their savings away from UCITS and towards savings deposits and life insurance products that are not covered by the FTT in the Commission's proposal. This would distort even more the **level playing field** between providers of long-term savings products, and endanger the future of UCITS, and would ultimately reduce the choices available to EU citizens for savings. This would be totally unjustified in light of the reputation that UCITS has acquired as a model of excellence in the long term savings market.

All these reasons lead EFAMA to request the **European Commission** to re-examine its proposal in light of the original goals of the proposal.

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Annex 1

Table A1: Estimation of the Impact of the FTT on the UCITS Industry

UCITS Market Data: Central Scenario

UCITS type	Net assets [1] A	Annual portfolio turnover rate (UCITS) [2] TR	Annual portfolio turnover ratio [3] Tr	Total gross sales & redemptions of units T1	Portfolio management securities transactions [4] T2	Total transactions in securities T
	(EUR millions)			(EUR millions)	(EUR millions)	(EUR millions)
Equity	2,000,898	0.7	0.7	1,547,089	1,400,628	2,947,717
Bond	1,452,570	1.0	1.0	1,497,855	1,452,570	2,950,424
Balanced	912,786	1.0	0.9	705,620	912,786	1,618,405
MMF	1,112,206	3.0	6.5	11,170,163	3,336,617	14,506,780
Other	343,571	1.1	1.4	565,191	377,928	943,119
Total	***5,822,030***			***15,485,917***	***7,480,529***	***22,966,446***

Estimation of FTT on UCITS [5]

UCITS type	FTT on gross sales & redemptions of units (EUR millions)	FTT on total portfolio transactions (EUR millions)	FTT total annual revenue (EUR millions)	FTT total annual revenue (share in total)	FTT total annual revenue (% of assets)	FTT on total transactions in securities (% of assets)
Equity	1,547	2,948	4,495	11.7%	0.22%	0.15%
Bond	1,498	2,950	4,448	11.6%	0.31%	0.20%
Balanced	706	1,618	2,324	6.0%	0.25%	0.18%
MMF	11,170	14,507	25,677	66.8%	2.31%	1.30%
Other	565	943	1,508	3.9%	0.44%	0.27%
Total	***15,486***	***22,966***	***38,452***	100.0%	0.66%	0.39%

[1] Average net assets over the period end 2010 & end 2011.

[2] "TR" reports the turnover rate following the UCITS rules, i.e. by measuring portfolio turnover in relation to the transactions relating to active portfolio management. TR is defined as follows:

A = Average of total net assets

T = Total purchases and sales of securities (including purchases and sales related to subscriptions and redemptions of fund units)

T = T1 + T2

T1 = Total subscriptions and redemptions (= total transactions in fund units)

T2 = Total portfolio management securities transactions (= purchases and sales of securities, excluding purchases and sales related to subscriptions and redemptions)

TR = Portfolio turnover rate

==> TR = (T2/A) = (T - T1)/A.

The turnover rates shown in this column represent the average (median) of turnover rates in a large sample of funds distributed in Europe.

Using the turnover rates it is possible to derive the total portflio management securities transactions (T2) and the total transactions in securities (T).

[3] "Tr" is an alternative indicator of a fund's turnover. It measures the percentage of a fund's holdings that is replaced with other holdings in a given year. If a fund manager sells in a given year. If a fund manager sells all of the old positions and uses the proceeds to purchase an entirely new portfolio with all of the account assets, the turnover ratio is 100%, or 1 in absolute terms. Tr can be calculate by using the following formula:

Tr = T/2/A

[4] As explained in footnote 2, "T2" is calculated using the following formula: T2 = TR x A.

[5] FTT rate 0.10%