European Fund and Asset Management Association

Potential Impact of the new version of the FTT on the UCITS Industry

1. Direct Cost of the FTT

The Financial Transactions Tax (FTT) adopted by the European Commission in February 2013 will be implemented under enhanced co-operation by 11 member states. This FTT zone will apply a tax on financial transactions with an established link to the FTT zone, therefore also affecting UCITS domiciled outside of the FTT zone, which buy securities issued within the FTT zone. The issuance of UCITS shares/units will be exempt from the FTT, although the FTT will apply to the redemptions of UCITS shares/units as well as to the UCITS portfolio transactions.

Given that the FTT will greatly impact the industry, EFAMA has estimated the cost to end clients of such a tax. The results are summarized in Table 1 below. The key assumptions and results of the calculation are presented in Annex 1, whereas the details concerning the FTT zone are presented in Annex 2, with details on the non-FTT zone calculations being presented in Annex 3.

Table 1

Summay of FTT in 2011			
Zone	FTT on gross redemptions of units (EUR millions)	FTT on total portfolio transactions (EUR millions)	FTT total annual revenue (EUR millions)
FTT Zone	3,054	4,289	7,343
Non-FTT Zone	1,235	4,448	5,683
Total	4,289	8,738	13,026

The following comments can be made:

- The total impact of the FTT would have reached **EUR 13 billion** assuming that the FTT had been applied at the start of 2011, all other things being equal. This is made up of EUR 7.3 billion attributed to FTT zone countries and EUR 5.7 billion attributed to non-FTT zone.

- The tax would have levied **EUR 4 billion on the redemptions of UCITS shares/units**. This figure can be derived by applying the proposed FTT tax rate of 0.1% to the total redemptions

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of UCITS in 2011 in the FTT zone (EUR 3.1 billion) and to non-FTT domiciled funds selling to investors located within the FTT zone (EUR 1.2 billion).

- The potential impact of the proposed FTT at the portfolio level would depend on the turnover ratio of UCITS portfolios. It is estimated that the FTT would have levied **EUR 9 billion on the UCITS portfolio transactions** in 2011, all other things being equal. This consists of EUR 4.3 billion from the FTT zone and EUR 4.5 billion from non-FTT zone countries.

- The results reflect the following average FTT annual cost relating to portfolio transactions: **23 basis points** for UCITS domiciled in the FTT zone (12 bps for equity funds, 18 bps for bond funds, 16 bps for balanced funds and 50 bps for MMFs) and **11 basis points** for UCITS domiciled outside the FTT zone (6 bps for equity funds, 12bps for bond funds, 9 bps for balanced funds and 23 bps for MMFs).

Last year EFAMA estimated that the FTT would cost the UCITS industry EUR 38.5 billion in additional taxes. This estimate differs to the current estimation for the following reasons:

- **Lower FTT impact on portfolio management of MMFs (EUR 9.4 billion)**: we have assumed that the gross sales and redemptions of MMF units will lead to very limited trading of securities subject to the FTT as (i) securities bought at primary issuance are exempt from the FTT and (ii) MMF managers will put in place mechanisms to limit the purchases/sales of securities to cope with the gross sales and redemptions of MMF units as these sales/redemptions tend to offset each other. Following this approach, we have reduced the annual cost of the FTT on MMFs from 130 to 50 basis points, excluding the impact of the FTT on the redemptions of MMFs units.

- **Lower FTT impact on portfolio transactions of UCITS domiciled outside the FTT zone (EUR 5 billion)**: we have assumed that (i) the purchases/sales of securities linked to active portfolio management can be split between securities issued in the FTT zone and securities issued outside the FTT zone, using ECB data on the portfolio composition of euro area investment funds; (ii) the purchases/sales of securities issued outside of the FTT zone are not subject to the FTT.

- **No FTT impact on gross sales of UCITS (EUR 7.8 billion)**: we have assumed that the issuance of UCITS shares/units will be exempt from the FTT.

- **Lower FTT impact on redemptions of UCITS domiciled outside the FTT zone (EUR 3.6 billion)**: we have assumed that only Luxembourg domiciled UCITS will be affected by the FTT on fund redemptions to the extent that they are sold to investors based in the FTT zone through round-trip and other cross-border funds. This means that we have assumed that (i) the UCITS domiciled in the other countries located outside the FTT zone are sold to domestic investors and (ii) Irish domiciled funds are sold outside the FTT zone, in particular in the UK.

2. EFAMA's Key Concerns

The potential **impact of the FTT** could be significantly bigger than assumed above. 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 4.3 billion in FTT tax payments for their redemptions. This would reduce considerably the competitive advantage of UCITS.

The cost and effort for fund managers to **adapt administering systems** to deduct FTT from the proceeds of the redemption of fund units would be significant, in particular from the perspective of funds domiciled in non-participating member states. Moreover, it remains unclear how the tax would be applied to aggregated redemption orders from large distributors operating in many countries in and outside the FTT zone. If distributors are required to create separate orders for investors where the FTT is applicable or not, it still remains unclear as to how fund management companies will be able to distinguish between such orders.

The impact of the FTT on the **MMF** industry would be very significant, in particular for the MMFs domiciled in the FTT zone. The cost of the FTT would reduce the annual investment performance of MMFs by at least 1%.

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 UCITS would see the value of their savings reduced by EUR 7,216, or 15% of the person's total contributions.[1] 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.

Finally, the FTT will endanger the **Single Market** for UCITS by granting a competitive advantage to investment funds located outside the FTT-zone, thereby incentivizing relocations of funds and asset managers outside the FTT-zone.

[1] This estimate assumes that (i) the average net performance of the UCITS averages 5% per annum and (ii) the FTT would reduce this annual performance by 0.2 percent, from 5% to 4.8%.

Annex 1

Table A: Estimation of the Impact of the FTT on UCITS

UCITS Data

UCITS type	Net assets [1] A (EUR millions)	Annual portfolio turnover rate (UCITS) [2] TR	Annual portfolio turnover ratio [3] Tr	Total gross sales & redemptions of units T1 (EUR millions)	Portfolio management securities transactions [4] T2 (EUR millions)	Total transactions in securities T (EUR millions)
Equity	1,998,619	0.7	0.7	1,464,259	1,399,033	2,863,292
Bond	1,453,185	1.0	1.0	1,464,495	1,453,185	2,917,680
Balanced	903,655	1.0	0.9	681,316	903,655	1,584,971
MMF	1,111,301	3.0	6.7	11,570,794	3,333,904	14,904,698
Other	346,506	1.1	1.3	516,590	381,157	897,747
Total	***5,813,268***			***15,697,454***	***7,470,936***	***23,168,390***

Estimation of FTT [5]

UCITS type	FTT on gross 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	384	1,467	1,851	14.2%	0.09%	0.07%
Bond	388	1,989	2,377	18.2%	0.16%	0.14%
Balanced	225	1,076	1,301	10.0%	0.14%	0.12%
MMF	3,121	3,719	6,840	52.5%	0.62%	0.33%
Other	170	486	657	5.0%	0.19%	0.14%
Total	***4,289***	***8,738***	***13,026***	100.0%	0.22%	0.15%

[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 (<u>including</u> 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, <u>excluding</u> 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 portfolio 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 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 calculated 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%

Annex 2

Table A1: Estimation of the Impact of the FTT on UCITS managed in the FTT Zone

UCITS Data

UCITS type	Net assets [1] A (EUR millions)	Annual portfolio turnover rate (UCITS) [2] TR	Annual portfolio turnover ratio [2] Tr	Total gross sales & redemptions of units T1 (EUR millions)	Portfolio management securities transactions [2] T2 (EUR millions)	Total transactions in securities [3] T (EUR millions)
Equity	541,037	0.7	0.6	279,261	378,726	657,988
Bond	428,597	1.0	0.9	335,814	428,597	764,411
Balanced	396,573	1.0	0.8	232,222	396,573	628,795
MMF	427,277	3.0	7.3	4,978,388	1,281,831	6,260,218
Other	79,999	1.1	0.8	34,856	87,999	122,855
Total	***1,873,483***			***5,860,540***	***2,573,726***	***8,434,266***

Estimation of FTT [6]

UCITS type	FTT on gross redemptions of units [4] (EUR millions)	FTT on total portfolio transactions [5] (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	191	658	849	11.6%	0.16%	0.12%
Bond	197	764	961	13.1%	0.22%	0.18%
Balanced	138	629	767	10.4%	0.19%	0.16%
MMF	2,500	2,115	4,615	62.8%	1.08%	0.50%
Other	28	123	151	2.1%	0.19%	0.15%
Total	***3,054***	***4,289***	***7,343***	100.0%	0.39%	0.23%

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

[2] See footnotes 2, 3 and 4 at the bottom of table A.

[3] Total purchases and sales of securities including purchases and sales related to subscriptions and redemptions of fund units.

[4] We assume that all redemptions of funds domiciled in the FTT zone are subject to the FTT.

[5] For all funds except MMF, we assume that the purchases and sales of securities linked to active portfolio management and subscriptions and redemptions of fund units are subject to the FTT, independently of whether the securities are issued in the FTT zone or outside. For MMF, we assume that gross sales and redemptions of fund units will lead to very limited portfolio activities subject to the FTT, in particular, as securities bought at primary issuance are exempt from the FTT. Moreover, the high volume of gross sales and redemptions tend to offset each other, thus automatically avoiding the need to purchase/sell securities subject to the FTT.

[6] FTT rate 0.10%

Annex 3

Table A2: Estimation of the Impact of the FTT on the UCITS Managed Outside the FTT Zone

UCITS Data

UCITS type	Net assets [1]	Annual portfolio turnover rate (UCITS) [2]	Annual portfolio turnover ratio [2]	Total gross sales & redemptions of units	Portfolio management securities transactions [2]	Total transactions in securities [3]
	A	TR	Tr	T1	T2	T
	(EUR millions)			(EUR millions)	(EUR millions)	(EUR millions)
Equity	1,457,582	0.7	0.8	1,184,998	1,020,307	2,205,305
Bond	1,024,588	1.0	1.1	1,128,681	1,024,588	2,153,269
Balanced	507,083	1.0	0.9	449,094	507,083	956,177
MMF	684,025	3.0	6.3	6,592,407	2,052,074	8,644,480
Other	266,507	1.1	1.5	481,734	293,158	774,892
Total	***3,939,785***			***9,836,914***	***4,897,210***	***14,734,124***

Estimation of FTT [6]

UCITS type	FTT on gross redemptions of units [4] (EUR millions)	FTT on total portfolio transactions [5] (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	193	809	1,002	17.6%	0.07%	0.06%
Bond	191	1,224	1,416	24.9%	0.14%	0.12%
Balanced	87	447	534	9.4%	0.11%	0.09%
MMF	621	1,604	2,225	39.2%	0.33%	0.23%
Other	142	364	506	8.9%	0.19%	0.14%
Total	***1,235***	***4,448***	***5,683***	100.0%	0.14%	0.11%

(1) Average net assets over the period end 2010 & end 2011.
(2) See footnotes 2, 3 and 4 at the bottom of table A.
(3) Total purchases and sales of securities including purchases and sales related to subscriptions and redemptions of fund units.
(4) For funds located outside the FTT zone, we assume that only the Luxembourg domiciled funds will be affected to the extent that they are sold to investors based in the FTT zone,
through round-trip and other cross border funds, i.e. we assume (1) the other non-FTT zone funds are domestic; (2) Irish domiciled funds are sold outside the FTT zone.
We assume 55% of the redemptions from Luxembourg domiciled funds are ordered by investors located within the FTT zone.
(5) We assume that only the purchases and sales of securities issued in the FTT zone are subject to the FTT. To determine the share of securities, which are issued in the FTT zone and held by UCITS domiciled outside the FTT zone, we have used ECB data on the portfolio composition of euro area investment funds.
On this basis, we have used the following percentages for securities issued in the FTT zone: equity funds (37%), bond funds (57%), MMF (47%),
for balanced funds and others we have used the average of holdings by equity and bond funds (47%).
In addition for MMF, we have also assumed, as for the FTT countries, that gross sales and redemptions of fund units will lead to very limited portfolio activities subject to the FTT.
(6) FTT rate 0.10%